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Response to ESMA Consultation Paper on
Proposed Revisions to Commission Delegated Regulation (EU) 447/2012 and Annex I of CRA Regulation

S&P Global Ratings Europe Limited ("SPGRE") appreciates the opportunity to provide comments to the European Securities and Markets Authority ("ESMA") on its 'Proposed Revisions to Commission Delegated Regulation (EU) 447/2012 and Annex I of CRA Regulation' (the "Consultation Paper").

The Consultation Paper sets out proposals for (i) a Commission Delegated Regulation amending the regulatory technical standards laid down in Delegated Regulation (EU) No 447/2012 for the assessment of compliance of credit rating methodologies (the "Delegated Act"), and (ii) changes to Annex I of the Regulation 1060/2009 on Credit Rating Agencies (as amended, "CRAR").

The Legislative Mandate setting out the Request for Technical Advice ("Legislative Mandate") of the European Commission ("Commission") concerned the incorporation of Environmental, Social and Governance factors into the Delegated Act and CRAR. In addition to what was requested through the Legislative Mandate, ESMA also proposes to introduce into the Delegated Act a definition of 'methodologies', and references to rating outlooks (as defined in CRAR).

We respond below to each of the questions posed by ESMA in the order in which they appear in the Consultation Paper, and also provide some general comments regarding rating outlooks. As explained in our responses, we have serious concerns with the proposals.

SPGRE incorporates ESG factors into its credit ratings when we believe they are material to creditworthiness and sufficiently visible. We have been, and remain, committed to enhancing the transparency of how ESG factors can influence creditworthiness through the application of our methodologies and in our credit ratings publications. Our Environmental, Social, And Governance Principles In Credit Ratings criteria ("ESG Principles Criteria") article, for example, articulates the principles that SPGRE applies to incorporate ESG factors, where relevant, into its credit ratings analysis through the application of our sector-specific criteria.

Our overarching concern is that ESMA's proposals may require CRAs to make significant changes not just to the form but also the substance of their methodologies and criteria articles. This would be inconsistent with the prohibition on interfering with the content of methodologies in Article 23 CRAR and risk creating significant market confusion, including as to the meaning of credit ratings.

For one, we respectfully request the proposals be reconsidered and revised, as appropriate, to ensure no CRA is required to change the substance or form of its methodologies to incorporate or reflect ESG factors where its methodologies do not do so. SPGRE's credit ratings measure creditworthiness, representing a forward-looking opinion on the capacity and willingness of an entity to meet its financial commitments as they come due. As we have noted publicly, strong creditworthiness does not necessarily correlate with strong ESG characteristics and vice versa. Furthermore, environmental, and social analysis is not a separate category of credit analysis within our sector-specific methodologies.

Accordingly, requiring CRAs to label components of analysis contained within their methodologies as being either an E, S or G factor, when they are not designed for that purpose, could mislead users of credit ratings. They may understand that E, S or G factors have an overriding importance within credit analysis, as compared to other factors, which they do not. Doing so may also result in users of credit ratings drawing inferences that credit ratings are akin to an ESG rating when they are not.

For the reasons explained below we also disagree with the proposed introduction of rating outlooks and a definition of 'methodologies', which exceeds the Legislative Mandate.

Lastly, SPGRE notes that the recently agreed 'Regulation amending Regulation 575/2013' (the "CRR Amendment", legislative number 2021/0342(COD)) includes a mandate for ESMA, by 12 months after the entry into force of the CRR Amendment, to prepare a report on 'whether ESG risks are appropriately reflected in ECAI credit risk rating methodologies', following which the Commission may submit a legislative proposal. As the Legislative Mandate predates the CRR Amendment, we respectfully suggest that ESMA seek further guidance from the Commission before submitting the proposed Delegated Act and its accompanying Final Report, in order to avoid a succession of different legislative changes regarding the incorporation of ESG Factors by CRAs.

Regarding the proposed inclusion of references to 'rating outlooks':

SPGRE does not support the proposed additions of rating outlooks to the Delegated Act. The additions may create consequences not intended by the co-legislators of Regulation 462/2013 ("CRA3"), and do not seem necessary. Any references to rating outlooks in the Delegated Act should be limited in scope to apply only to the extent a CRA chose to incorporate rating outlooks into its rating methodologies.

Changes inconsistent with CRAR and Validation Guidelines

CRA3 deliberately extended only certain specific CRAR requirements to rating outlooks, and not all of them (see e.g. Recital 7 to CRA3 ("*specific* [emphasis added] provisions apply to such rating outlooks"). Importantly, while rating outlooks were added in Article 8(2), they were not included in Article 8(2a), which was introduced through CRA3 to require that "Changes in credit ratings shall be issued in accordance with the credit rating agency's published rating methodologies". Other relevant examples include Article 8(5), (5a) and (6), point 2a of Annex I Section D concerning 'models and rating methodologies used in credit ratings', and Article 21(4)(d). We also note that neither ESMA's Guidelines on the validation and review of Credit Rating Agencies' methodologies ("Validation Guidelines"), nor ESMA's proposed amendment of point 2a refer to rating outlooks.

Unintended consequences

The consequence of adding rating outlooks to the Delegated Act would appear to be a new requirement for CRA methodologies to incorporate frameworks for rating outlooks as distinct from credit ratings and, consequently, for rating outlooks to be included in CRA methodology validations. We do not believe this was intended by CRA3, which, through their targeted addition, took into account the important differences between rating outlooks and credit ratings:

SPGRE's credit ratings are a forward-looking opinion of creditworthiness that reflects a view of the obligor's capacity and willingness to meet its financial commitments when they fall due. SPGRE's 'rating outlook' and 'CreditWatch' are defined in our Ratings Definitions and indicate SPGRE's views regarding the degree of likelihood of a rating change and, in most cases, the probable direction of that change. Credit ratings are the outcome of how a rating committee *has* applied a rating methodology given a specific set of facts, circumstances and expectations. Conversely, rating outlooks are an indication of how a future rating committee *might* apply the rating methodology if certain facts, circumstances and expectations were to materialize. Such facts, circumstances and expectations may or may not materialize. For example in determining a rating outlook, consideration is given to any changes in economic and/or fundamental business conditions. The implication, as stated in our Rating Definitions, is that "Although many rating changes are preceded by a CreditWatch placement or a non-stable outlook, changes can and should occur even when the outlook is stable or the rating is not on CreditWatch but when a sudden change in the creditworthiness can be assessed immediately. Also, a positive or negative outlook is not necessarily a precursor of a future rating action or CreditWatch listing."

We believe there is no need for separate specific or additional disclosure in rating methodologies pertaining to rating outlooks. This is because, at least in SPGRE's case, the process of determination of a rating outlook fundamentally reflects consideration of the same rating factors that are relevant for the determination of the credit rating itself, since it is a view on the future application of the same rating methodology that underpins the current credit rating and likely outcome thereof. The process of ascribing a certain likelihood of rating change upon the possibility of future conditions materializing is fundamentally about applying judgement as to whether a scenario is more likely than another; the same factors are considered as when determining the related credit rating, but the process of ascertaining a given degree of likelihood of future rating change is fully the domain of application of judgment.

From a validation standpoint, we believe it is reasonable to have an expectation that rating outlooks may generally foreshadow rating changes. However, since rating changes can and should occur even when the outlook is stable or the rating is not on CreditWatch (particularly when a sudden unexpected change in the creditworthiness can be assessed immediately), observing situations where a rating outlook was not an actual precursor to a rating change cannot be deemed to have been an unexpected or unintended outcome. From that standpoint, we believe that validation methods that are applied to assess and measure the historical robustness and predictive power of credit ratings (whereby an actual binary outcome of default or non-default that is independent of any judgment is available ex-post to inform the accuracy of the forward-looking assessment) cannot simply be extended to measuring the historical robustness and predictive power of rating outlooks. Any method used to assess the performance of rating outlooks would need to acknowledge the fundamental differences that exist between rating outlooks and credit ratings. Otherwise such process risks being, at the minimum, of limited value, or more problematically, could create unintended consequences when the results of such measurements are then interpreted.

Changes not necessary

The Delegated Act could have been amended at the same time as the CRAR but was not. ESMA's stated goal is to now align the Delegated Act with the changes made to CRAR through

CRA3, but the Consultation Paper does not articulate any observed consequences, negative or otherwise, of not amending the Delegated Act since CRA3 became effective.

As noted above, SPGRE's rating outlooks are defined, and hence are determined in accordance with, our Ratings Definitions. To comply with the relevant requirements in CRAR regarding quality, transparency, and conflicts of interests, SPGRE's relevant policies applicable to credit ratings also apply to rating outlooks.

Considering this and the fact that the Legislative Mandate does not extend to rating outlooks, we do not believe the proposed changes are necessary.

Any references to rating outlooks to be limited in scope

Should ESMA nevertheless proceed with adding references to rating outlooks in the Delegated Act, these should be limited in scope to apply only to the extent a CRA chose, unlike SPGRE, to incorporate rating outlooks into its rating methodologies.

Q1: ***Do you agree with the above proposed changes in Article 1? If not, please explain.***

We do not support the proposed changes in Article 1 and Articles 3(2)(a) Delegated Act. The proposed definition of "methodologies" is overly broad and inconsistent with CRAR, and risks creating uncertainty as to CRAs' related requirements. The changes are not required to enhance the incorporation of ESG factors, and may exceed the Commission's legislative authority.

Proposed changes inconsistent with CRAR

CRAR does not currently include a definition of methodologies. In some places, e.g. Article 8(1), CRAR refers to the "methodologies, models and key rating assumptions", implying, that models may be separate, rather than necessarily a part of, methodologies. In others, e.g. Article 8(5), CRAR refers to "methodologies" only, implying that the relevant requirements apply to methodologies only but not also models (unless the CRA chose to incorporate models into its methodology). ESMA's own Validation Guidelines state that "The word 'methodology' is used in this document as to mean all components that a credit rating methodology *may consist of* [emphasis added], including models, key rating assumptions and criteria". All of this reflects and acknowledges that it is for CRAs alone to determine the content of their methodologies, consistent with Article 23 CRAR.

We are concerned that as drafted, ESMA's proposed definition of methodologies would prescribe that *all* models and rating assumptions are a necessary part of methodologies, contrary to CRAR and the Validation Guidelines.

In practice, this risks creating uncertainty as to how the term methodologies should be interpreted for CRAR purposes. ESMA's proposed amendment to its Article 1 would, on its face, limit the application of the new definition to the Delegated Act. But given that the Delegated Act's purpose is not to create separate requirements but to provide greater detail on how to comply with Article 8(3) CRAR, the definition can be expected to be used by ESMA to define the requirements in that provision. This would *de facto* amend CRAR by adding a new definition to those in Article 3 CRAR, and thereby exceed the Commission's legislative authority.

Changes not required

In our view, a new definition of methodologies is neither necessary nor, in light of the above, desirable to fulfill the Legislative Mandate in connection with ESG Factors in CRA methodologies. ESMA proposed changes to Article 4(2) Delegated Act would require CRAs to identify whether qualitative and quantitative driving factors are considered ESG factors. Article 4(1) Delegated Act already requires the incorporation of relevant driving factors into CRA methodologies. In other words, a new definition of methodologies is not necessary in order to require CRAs to identify relevant driving factors in their methodologies and whether these are E, S or G Factors.

ESMA argues that a new definition is necessary as a CRA may otherwise exclude from its "methodologies" some 'documents' which include elements of the CRA's rating methodology. However, what forms part of a CRA's methodology to determine its credit ratings must, consistent with Article 23, only be determined by the CRA, rather than the Commission or ESMA. ESMA's role is to assess whether what the CRA denotes as its methodologies complies with CRAR and the Delegated Act. Indeed, ESMA has previously agreed with this position. See for example, ESMA's November 2016 Final Report on Guidelines for Validation, on page 7 in the first para where it stated that "the Guidelines do not imply or suggest interference with the content, product or rating philosophy of CRA's credit ratings or methodologies (e.g. paragraph 8 of the Feedback Statement and paragraph 12 of the Validation Guidelines). *CRAs can include in their methodologies any factors/criteria/ assumptions/models they deem relevant to their approach* [emphasis added]".

For example, if a CRA were to use key driving factors to determine its credit ratings that are included in documents that fall outside of, and are not also included in whatever the CRA has identified as its "methodologies", then the CRA would seemingly have failed to comply with the rigorousness requirement in Article 8(3) CRAR and Article 4(1)(d) Delegated Act. If, on the other hand, the driving factors are included in both one of the CRA's "methodologies" document as well another document not denoted as such, say a training presentation or a commentary, the CRA would comply with this requirement.

The definition's wording

Although we believe it is neither necessary, beneficial nor appropriate to introduce a definition of methodologies, we provide here comments on its wording that exemplify further the risk of unintended consequences:

The first prong of the definition, as drafted, would risk including a wide range of documents not presently considered methodologies by CRAs and their regulators globally. For example, a CRA's policies and procedures, internal controls, rating process, training, etc. are, arguably, all part of the "framework that contributes to" the determination of the CRA's rating. The definition's wording would also appear to mandate that rating outlooks be included in a CRA's methodologies even when the methodologies are not designed to do so. To avoid these consequences, the definition would need to be narrowed by amending the wording to "methodological framework that is used in ~~contributes to~~ the determination of a credit rating ~~and rating outlooks~~".

The definition's second sentence, which enumerates elements included in a methodology, is inconsistent with CRAR, as discussed above, and Article 4(1)(d) Delegated Act. The references to 'methodologies, models and key rating assumptions' in CRAR and the wording "where these are in place" in Article 4(1)(d) reflect that not all CRAs use each of these elements as part of their methodology to determine creditworthiness.

For example, CRAs may choose to adopt methodological approaches that are text based, incorporate transparent descriptions of qualitative and quantitative assessments and key ratings factors, explained through narrative descriptions contained in their published methodologies. In this scenario CRAs may use models (e.g. spreadsheets and calculators) as tools to help implement elements of the published methodologies, in a manner consistent with those methodologies. Models used as tools by CRAs to help implement published and transparent ratings methodologies in a manner that is both consistent with the published methodologies and helps to generate consistent applications of those published methodologies are themselves not methodologies. Discretely defining models to be a part of methodologies would be inconsistent with the current accepted practice by CRA regulators globally and market participants regarding the distinction between models that are used to help implement methodologies versus methodologies themselves. If models were required to be equated to methodologies this could trigger unintended consequences, such as the requirement for model spreadsheets to be subject to a public request for comment. A request for comment for a model that is merely used to help implement a methodology would serve no purpose in supporting ratings quality, unduly burden CRAs with seeking market comments on model coding and reduce the ability to update models in a timely manner to support the consistent application of methodologies, and risks confusing market participants.

To avoid these, presumably unintended, consequences, the definition would need to be narrowed in scope by amending the second sentence to "It may include~~s~~ criteria, models, driving factors and key rating assumptions relevant to the creditworthiness assessment as determined by the credit rating agency".

Q2: ***Do you agree with the changes proposed in Article 3? If not, please explain.***

We do not support the addition of the proposed second and third sentences to this paragraph for the reasons noted in response to Q1 and, with respect to rating outlooks, our general comments above.

Q3: ***Do you agree with the changes proposed in Article 4(1)(d)? If not, please explain.***

We do not support the proposed deletion in sub-paragraph (d). As noted in our response to Q1, the wording 'where these are in place' appropriately reflects that not all CRAs use each of these elements as part of their methodology to determine creditworthiness. Consistent with the references to "methodologies, models and key rating assumptions" in CRAR and Article 23 CRAR, Article 4(1)(d) Delegated Act does not require that a CRA includes models, assumptions and criteria in its [definition of] methodologies. Instead, the sub-paragraph mandates that if a CRA designed its methodologies so to include any of these elements, the elements used must be reliable, relevant and quality related.

Q4: ***Do you agree with the proposed changes in Article 4(2) to the Delegated Regulation? If not, please explain.***

SPGRE is concerned that the proposed changes might require CRAs to make extensive and potentially substantive changes to their inventory of criteria articles, which we believe could lead to market confusion and are not necessary to achieve the aim of enhancing transparency around the integration of ESG factors.

Concerns regarding the proposed change from "list and provide" to "use and apply"

The Consultation Paper acknowledges the current wording of Article 4(2) can be interpreted to outline what CRAs must list and provide to ESMA upon request, rather than to set requirements for the content or format of CRA methodologies. This is consistent with Article 1, according to which the Delegated Act "lays down rules to be used *in the assessment of compliance* [emphasis added]" of methodologies with CRAR. ESMA's proposed changes would create new requirements regarding the content or format of methodologies.

CRA methodologies already need to include qualitative and quantitative driving factors under Article 4(1). However, the proposed changes to Article (4)(2), that is the change from "list and provide" to "use and apply" in the first sentence combined with the additions of paragraphs (c), (d) and (e), as well as the additions to (a) and (b) regarding ESG, may require CRAs to make significant changes to the current content and format of their criteria articles, as specified below. SPGRE is concerned that adding potentially large volumes of disclosures will increase complexity and decrease the overall readability of criteria articles and risks confusing and distracting readers. Such changes could be very cost-intensive and time-consuming, might require a large number of public requests for comments, and risk creating significant market confusion at a time when a large number of other CRAs may also consult on changes to their criteria inventory. S&P Global Ratings' criteria inventory alone includes approximately 200 articles, many of which are global in scope, that is they extend beyond the determination of just EU credit ratings.

Should ESMA nevertheless proceed with this change, CRAs should at least be given flexibility as to where to include additional disclosures. Similar to CRAR's rules on the presentation of credit ratings and rating outlooks, CRAs should have the option to include additional disclosures outside individual criteria articles, e.g. on a dedicated page of the CRA's public website.

Specific concerns and suggestions re the requirement to "list" in paragraphs (a) and (b)

If ESMA proceeds with the proposed change to the first sentence of Article 4(2) despite our above concerns, we would request the following change in paragraphs (a) and (b): "~~list~~ <u>include</u> each". This would clarify that CRAs are not expected to reformat or otherwise amend their criteria articles to introduce additional 'lists' of driving factors.

Specific concerns and suggestions re the requirement to identify ESG factors in paragraphs (a) and (b)

What forms part of a CRA's methodology to determine its credit ratings must, consistent with Article 23 CRAR, be determined by the CRA, rather than the Commission or ESMA. ESMA's role is to assess whether what the CRA denotes as its methodologies complies with CRAR and the Delegated Act.

Not all CRAs may use E, S and G factors as part of their methodology to determine creditworthiness. We, therefore, believe it is neither beneficial from a transparency perspective nor appropriate from a methodological independence standpoint to introduce a requirement that CRA methodologies be amended to distinctly identify and label each quantitative and qualitative factor as an E, S or G factor where a CRA's methodologies have not been designed to do so.

In the case of SPGRE, environmental and social analysis is not a separate category of credit analysis within our sector specific methodologies. We have, however, published our ESG Principles Criteria article, which enhances the transparency of how ESG factors can influence creditworthiness. In addition, we continue to publish commentary and thought leadership articles to help users of our ratings understand how the influence of ESG credit factors on creditworthiness may change over time.

Our ESG Principles Criteria article explains how a factor that could be reasonably considered to be environmentally or socially related and which could influence creditworthiness would be captured in our credit ratings analysis. We describe that this is done through the application of our existing sector specific methodology and the categories of analysis thereto. As we further explain by way of example, a policy decision to levy carbon taxes, which could be reasonably considered as being environmentally related would be reflected in the cash flow/leverage component of analysis of the corporate sector methodology as the tax would lower the company cash flows. In contrast there are factors that can affect the company cash flows that would not be in any way related to environmental or social factors (for example, a decline in sales due to changes in non-environmentally related consumer preferences). As we point out in our ESG Principles Criteria, strong creditworthiness does not necessarily correlate with strong ESG characteristics and vice versa.

Accordingly requiring CRAs to label components of analysis contained within their methodologies as being either an E, S or G factor, when they are not designed for that purpose, could mislead readers of methodologies as to the meaning of credit ratings and the importance of E, S or G factors to creditworthiness. For example, readers of methodologies may mistakenly understand that E, S or G factors have an overriding importance within credit analysis, as compared to other factors, which they do not. Doing so may, in addition, result in users of credit ratings mistakenly drawing inferences that credit ratings are akin to an ESG rating when they are not.

Also, given the lack of consensus amongst global market participants as to the meaning of E, S and G factors, the proposal could potentially lead to the unintended consequence of undermining the goal of transparency through the creation of lists that are mere arbitrary classifications of E, S and G factors in CRA methodologies.

To avoid interference with a CRAs methodologies, consistent with Article 23 CRAR, and to avoid confusion as to the meaning of CRA methodologies, the proposed wording of 4 (2) (a) and 4 (2) (b) would need to be clarified as follows:

(a) "list each qualitative factor, including the scope of qualitative judgement for that factor and identify, ~~where applicable,~~ only where a CRA incorporates the following factors as discrete inputs to its methodologies, whether a factor is considered as an E factor, S factor or G factor".

(b) "list each quantitative factor, and identify, ~~where applicable,~~ only where a CRA incorporates such factors as discrete inputs to its methodologies, whether a factor is considered as an E factor, S factor or G factor".

We also refer you to our response to Q9 below concerning the terms 'E', 'S' and 'G'.

Specific concerns and suggestions re paragraph (c)

It is unclear to us what exactly the proposed new paragraph (c) would be requiring CRAs to include in their methodologies and to what purpose.

We assume 'the creditworthiness assessment' is intended to mean a CRA's credit rating methodology, but note the term is more commonly understood as the assessment of creditworthiness of a given issuer or instrument by the CRA's analysts. We are also unsure what 'rationale' CRA's would be expected to include and in what detail: paragraph (36) of the Consultation Paper suggests the rationale should make it clear *how* qualitative and quantitative factors are considered in the determination of credit ratings pursuant to the CRA's rating methodology. However, the wording of paragraph (c) suggests the rationale should explain *why* the CRA chose to include the factors in its methodology. If ESMA proceeds with the proposed addition of paragraph (c) despite our above concerns, we would request it clarifies the provision's wording.

Specific concerns and suggestions re paragraph (d)

If ESMA proceeds with the proposed change to the first sentence of Article 4(2) despite our above concerns, we would request paragraph (d) be clarified as follows: "include, where relevant, the key variables, data sources, key assumptions, modelling, and quantitative techniques applicable to the quantitative and qualitative factors used".

Specific concerns and suggestions re paragraph (e)

As noted above in the case of SPGRE, environmental and social analysis is not a separate category of credit analysis within our sector specific methodologies. Nor do environmental or social factors represent a discrete input in any of our methodologies. Given this, while the proposed text would not be relevant to SPGRE, we believe that it would be unusual, problematic and arguably not serve the goal of transparency for methodologies to include process information beyond the methodological content itself. We note that CRA methodologies today do not contain process related information and to require the provision of such information for a subset of factors would unduly elevate E, S and G factors to a level of importance in the analysis of creditworthiness that they do not have.

If ESMA proceeds with this change, we would request the provision be clarified as follows:

> "include the process according to which a qualitative or quantitative factor has been identified as an E factor, S factor or G factor, <u>only where a CRA incorporates the following factors as discrete inputs to its methodologies</u>".

Q5: ***Do you agree with the above proposed changes in Article 4(3) to the Delegated Regulation? If not, please explain.***

Please see our comments and concerns noted above in response to Q 4, particularly regarding the proposed change from "list and provide" to "use and apply" in the first sentence of Article 4(2) Delegated Act.

Please also see our general comments above regarding rating outlooks. Any new requirement regarding rating outlooks in Article 4 (3) should only apply to the extent a CRA has chosen to incorporate rating outlooks into its rating methodologies.

Q6: ***Do you agree with the above proposed changes in Article 5 to the Delegated Regulation on Methodologies? If not, please explain.***

Please see our general comments above regarding rating outlooks. The proposed additions would suggest that CRA methodologies must incorporate frameworks for rating outlooks as distinct from credit ratings.

Q7: ***Do you agree with the above proposed changes in Article 6 to the Delegated Regulation on Methodologies? If not, please explain.***

Please see our general comments above regarding rating outlooks. The proposed additions would suggest that CRA methodologies must incorporate frameworks for rating outlooks as distinct from credit ratings.

Q8: ***Do you agree with the proposed changes in Article 7 to the Delegated Regulation? If not, please explain.***

Please see our general comments above regarding rating outlooks, including our concerns with requiring the performance rating outlooks to be included in the validation of credit rating methodologies. The proposed additions would suggest that CRA methodologies must incorporate frameworks for rating outlooks as distinct from credit ratings.

Q9: ***Do you agree with the proposed addition of new paragraph 5a in Annex I.D.I to the Delegated Regulation? If not, please explain.***

SPGRE supports transferring the disclosure requirements regarding ESG Factors in rating reports that are currently in Section 5.2 of ESMA's Guidelines on Disclosure into Annex I of CRAR. However, we are concerned the proposed new paragraph 5a would, as worded, unduly expand the current requirements.

Concerns with expanded scope

While the current disclosure requirements are limited to ESG factors that drove a *change* to a credit rating, the new wording would extend these to *all* ESG factors underlying a rating. We understand this would create new disclosure requirements in relation to the first issuance of a rating, and potentially also subsequent changes to that rating.

Regarding the first (initial) issuance of a rating: We are concerned that adding potentially very large and disproportionate volumes of disclosures on ESG considerations will increase complexity, decrease overall readability, and risk confusing and distracting readers from what should be the main purpose and focus of the initial rating report, namely the credit rating rationale. While the additional disclosures may increase transparency regarding ESG considerations, they may in fact decrease the overall transparency of the rationale underling a CRA's credit rating.

Regarding subsequent rating changes: as worded, paragraph 5a could be read to require that rating reports accompanying rating changes should identify the full list of ESG factors that underly a rating, that is all the factors already to be included in the initial rating report (subject to any changes), rather than just those factors that drove the rating change. If that is ESMA's intention, then we would point to our concerns outlined above regarding initial rating reports, which would also apply here. If that is not the intention, then we would request the wording be clarified accordingly.

Potential alternatives

Should ESMA pursue expanding the current disclosure requirements despite the concerns outlined above, we would ask ESMA to amend paragraph 5a to permit CRAs to make the additional ESG disclosure outside their press releases or rating reports. Allowing CRAs to disclose the full list of ESG factors they assess as underlying a rating on the CRA's website rather than in the rating report would reduce the risks outlined above of overemphasizing ESG factors to the detriment of the credit rating rationale and decreasing the readability and transparency of rating reports.

Definition of ESG

Lastly, we suggest the new paragraph 5a also includes wording similar to that in the Guidelines on Disclosure, which acknowledges that what is to be categorized as 'E', 'S' or 'G' is determined by the CRA, in the absence of a common definition of these terms. This clarification would address the risk that the paragraph might otherwise be interpreted, say in a future judicial proceeding, as requiring a common understanding of the term.

Q10: ***Do you agree with the proposed change in Annex I Section A paragraph 9 of the CRA Regulation? If not, please explain.***

SPGRE has no objection to this proposed amendment to CRAR.

Q11: ***Do you agree with the proposed change to Annex I. Section D.I paragraph 2a. of the CRA Regulation? If not, please explain.***

SPGRE has no objection to this proposed amendment to CRAR.

Q12: ***Do you see merit in requesting a disclosure of the use of technological innovations such as Artificial Intelligence (AI) in the rating process?***

We are unsure about this question in the context of this consultation, including any relevance to the Legislative Mandate and the other proposed changes to the Delegated Act and CRAR, as the Consultation Paper provides no explanation or detail.

As a general matter, we understand ESMA's interest in the use of innovative technologies by CRAs and can see circumstances in which a CRA may indeed choose to publicly disclose its use of AI. However, we would urge ESMA to conduct a thorough cost-benefit analysis before mandating any disclosure, in particular at a time when the technology, its use by CRAs, and AI-specific legislations are still evolving.

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