WWF response to ESMA CRAR L2 consultation, 21 June 2024

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

ESMA: The inclusion of a reference to ESG factors in the provisions of this Article of the Delegated Act will help ensure the more consistent and effective integration of ESG factors in the credit rating process

ESMA: Here, it is proposed that Article 4(2)(a) is revised to require CRAs to list each qualitative factor that the credit rating methodology refers to, the scope of judgement that is permitted under that factor and additionally identify, where applicable, whether each factor is considered to be an E factor, S factor, G factor.

ESMA: Further to this, ESMA is proposing that Article 4(2)(b) should be revised to require CRAs to list each **quantitative** factor, and identify, where applicable, whether a factor is considered to be an E factor, S factor or G factor.

WWF ANSWER:

We agree that not only qualitative but also quantitative factors should be explicitly listed, and that their identification as an E, S or G factor should be disclosed.

However, in our view ESMA should build on this drafting and include a reference to the type of materiality that the factor entails. While the main purpose of this article is to ensure the correct integration of ESG factors in credit ratings ("outside in" materiality), it is important for investors to be aware that certain factors also have an "inside out" relevance. This can be done by adding:

> ***"(f) include whether the qualitative or quantitative factor has any material inside-out E, S or G impact."***

The change would be in line with the final report from the High-Level Expert Group on sustainable finance, which in 2017 already flagged credit ratings as an important driver of sustainability and noted that "*a financial system that fully supports the EU's sustainability targets will be characterised by lending and investment processes into which ESG considerations are systematically integrated. This also means that all rating activities within the financial market must also have ESG factors at their core.*"

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

WWF ANSWER:

We strongly support this change but recommend to be even more explicit: the "weighting" (not "importance", which can still be rather vague instead of an exact numerical value) of individual factors must be disclosed, in line with requirements for disclosure of methodologies under the ESG Ratings regulation and the RTS in Article 21 of that regulation.

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.

ESMA: this way, ESMA will be endorsing what is already the industry standard for the disclosure of ESG factors in credit ratings, and placing it on a stronger legal footing

<u>WWF ANSWER:</u>

We have no objection to ESMA codifying an industry standard for the disclosure of ESG factors in press releases or reports, but we suggest a generic disclaimer that any ESG materiality assessment is made by the credit rating agency and that due to the subjective nature of the materiality assessment itself, it cannot be excluded that the credit rating could be impacted by ESG factors that the CRA considers non-material. This could be achieved by adding:

> ***"iii. explain what the process is for determining whether E, S or G factors are material, and that the absence of such disclosures does not imply that the credit rating could be influenced by E, S or G factors in general"***

The change above meets the recommendation from the the High-Level Expert Group on sustainable finance, which stated: "*It is critical important that CRAs disclose their methodology with respect to ESG and that a CRA should also disclose whether or not it is integrating relevant ESG aspects and associated information disclosed by issuers into its methodology."*