21 June 2024
European Securities and Markets Authority
ESMA
201-203 Rue de Bercy
CS 80910
75589 Paris Cedex 12

RE: Consultation Paper on the Proposed Revisions to Commission Delegated Regulation (EU) 447/2012 and Annex I of CRA Regulation (the "Consultation")

Dear Madam or Sir

Fitch Ratings ("Fitch") welcomes the opportunity to review and comment on the Consultation. We set forth below some overarching concerns; we have also provided detailed responses to the specific questions asked in a separate annex to this response. In addition, given the complex nature of some of these topics, we would greatly appreciate an opportunity to discuss our response with you in more detail and will reach out to ESMA separately on this point.

Credit Rating Agency Independence

Fitch is committed to addressing and disclosing ESG risks where and to the extent Fitch determines that they are materially relevant to the credit profile of a rated entity and in accordance with our relevant criteria. Our industry-leading ESG Relevance Scores (ESG.RS) were created before the introduction of ESMA's *"Guidelines on Disclosure Requirements Applicable to Credit Ratings"* and have been well-received by the market as a clear indication of how ESG risks affect an entity's credit rating.

However, while we strongly support clear disclosure of ESG risks where they are a key driver of credit ratings, we have several concerns about the proposals in the Consultation. Most importantly, we believe implementation of the Consultation proposals would result in interference with the content of CRA methodologies by requiring increased incorporation of ESG factors into methodologies. This intent is clear in several places in the Consultation, including the cost-benefit analysis, which states an objective of the consultation is to "ensure a better incorporation of ESG factors in the credit rating methodologies" and that a benefit will be "ensuring that CRAs will more consistently and robustly integrate ESG factors in their credit rating methodologies."

Similarly, in paragraph 11 of the Consultation ESMA states that it welcomes the opportunity "to revise the regulatory framework of the CRA Regulation to enhance transparency around the consideration of ESG factors **and their more systematic integration in the credit rating process**," (our emphasis).

Interfering with the content of methodologies in this way would be contrary to Article 23 of the Credit Rating Agency Regulation (the "CRAR") and would undermine the independence of CRAs, which is a core principle of the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies. This principle exists to prevent undue influence on credit ratings, including that rating decisions should be free from political or economic pressures. Interference in this manner would also be detrimental to the market, which values the independent analysis of CRAs.

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In addition, this proposed interference would undermine the scope for a multiplicity of views and approaches among CRAs – another characteristic of credit ratings that the market finds useful – by homogenizing certain aspects of CRA methodologies. It would also risk giving a misleading impression of the importance of ESG factors as a driver of credit ratings, as well as causing confusion regarding the difference between credit ratings and ESG ratings.

We disagree with ESMA's opinion (in its assessment of likely costs to the regulator) that the changes would not entail interference because, for example, they do not include a specific E, S, or G categorization. The simple intent to require increased integration of ESG factors in methodologies would by itself be interference.

For all these reasons, we strongly encourage ESMA to exercise caution when referring to "integration" of ESG factors into methodologies. If ESMA moves forward with these proposals, in Fitch's view, any changes made to the CRAR or to Delegated Regulation (EU) 444/2012 (the "Delegated Regulation") regarding such ESG factors should make it totally clear that the CRA has complete control over which factors, if any, it determines to be relevant to its methodology. While we note that there are references in various places to "relevant ESG risks" and similar language, we think that in all cases it should be clarified that it is always and only the CRA that determines relevance.

We believe these changes should be made not only to the language of the proposed amendments to the CRAR and the Delegated Regulation, but also in the Consultation itself to ensure the legislative history is clear. We have therefore also attached, in a second annex, a separate mark-up of the Consultation, solely for the purpose of indicating where we have concerns with the language of the Consultation itself with respect to this point and believe that clarification is needed.

Proposed Treatment of Rating Outlooks

Fitch is also concerned about the proposed introduction of rating outlooks within the scope of the Delegated Regulation. While we acknowledge the revision of the CRAR in 2013 to include references to rating outlooks in various places, we do not agree with ESMA's position that adding rating outlooks to the Delegated Regulation is necessary to align it with the CRAR. In particular, while Article 8(2) of CRAR was updated in 2013 to include rating outlooks, we do not believe this revision necessitates updating the Delegated Regulation, and we note that Article 8(2a), which requires changes in credit ratings to be issued in accordance with methodologies, does not make any reference to rating outlooks.

There are differences between rating outlooks and credit ratings which mean the specific requirements of the Delegated Regulation may be unhelpful or counterproductive for rating outlooks. Rating outlooks are not a type of credit rating or a separable credit view that modifies a rating; they are Fitch's view on the likely future direction of a credit rating, assuming the future re-application of the same methodology used to derive the credit rating.

In particular, Fitch's rating outlooks generally reflect Fitch's view on risks or trends that have not yet reached or been sustained at the level that would cause a credit rating action. Thus the rating outlook looks at how the methodology that is being applied to determine the credit rating suggests the credit rating may evolve in the future, if these trends continue. Therefore, by their nature they are highly qualitative assessments and, taken in aggregate, the pattern of rating outlook conversions (Negative Outlooks leading to credit rating downgrades and Positive Outlooks leading to upgrades)

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will often be influenced by the level of uncertainty or volatility of judgement in a marketplace or context, more than the underlying credit quality of the issuers.

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We expand on these and other points in our responses to the Consultation's questions in the separate annex to this response.

We would like to thank ESMA for the opportunity to provide our thoughts and recommendations with respect to the Consultation. We will reach out separately to discuss our feedback, but if you have any questions regarding our submission, please do not hesitate to contact me (at susan.launi@fitchratings.com).

Yours sincerely

Susan Launi

Fitch Ratings

Global Head of Regulatory Affairs