Moody's Deutschland GmbH
An der Welle 5
60322 Frankfurt am Main
Germany

+49.69.70730.700 tel
moodys.com

18 March 2025

Moody's Ratings' response to ESMA's Consultation Paper on Guidelines on Internal Controls for Benchmark Administrators, Credit Rating Agencies (CRAs) and Market Transparency Infrastructures

Moody's Ratings welcomes the opportunity to comment on ESMA's draft Guidelines on internal controls for supervised entities.

As ESMA outlines in the Consultation Paper, CRAs are already subject to ESMA's Guidelines on internal controls as published in September 2020 ("the 2020 Guidelines"). We understand that it is ESMA's intention to apply the new guidelines to a larger number of supervised entities than under the 2020 Guidelines, but not to substantially change or increase the expectations on CRAs.

Nevertheless, there are some areas where the new guidelines could indeed be interpreted as substantive changes. This is mainly due to the omission of certain materiality considerations and other qualifiers that underpin the scope of the 2020 Guidelines.

For proportionality and legal certainty, we have suggested, in Annex I, some targeted adjustments to the proposed draft guidelines to bring them into line with the 2020 Guidelines. Thank you for your consideration. We stand ready to provide any further information as helpful to ESMA's work.

Yours sincerely,

/S/ Nick Miller

Nick Miller

Managing Director – Global Regulatory Affairs

Annex I: Responses to ESMA's Questions

Q1. Do you have any comments on the proposed Guidelines under the section on IC Framework? In providing your comments, please refer to the general principle, component and/or characteristic that you are commenting on.

We suggest a few targeted amendments, as set out below.

a. Internal Control Framework – General Principles, paragraph 21 on page 11/ paragraph 15 on page 40

We suggest reintroducing a materiality provision, similar to the equivalent text of the 2020 Guidelines which referred to the policies and procedures that support the components of the IC framework. We also suggest removing the reference to "working practices" in the second sentence, as it goes beyond the scope of the internal control framework as set out in paragraph 20 in ESMA's Consultation Paper (page 11). The amendment would read as follows:

ESMA Proposed Language	Moody's Ratings Suggestion
The Management Body of the supervised entity should be accountable for overseeing and approving all components of the IC Framework as well as overseeing that those components are subject to monitoring and are regularly updated by the executive senior management. The supervised entity's executive senior management should be responsible for establishing, implementing and updating the written internal control policies, procedures and working practices.	The Management Body of the supervised entity should be accountable for overseeing and approving all components of the IC Framework as well as overseeing that those components are subject to monitoring and are regularly updated by the executive senior management. The supervised entity's executive senior management should be responsible for establishing, implementing and updating the written internal control policies~~,~~ **and** procedures ~~**and working practices**~~ **that substantially support the components of the IC Framework**.

b. Component 1.2.3, Internal Control Framework, pages 14 and 41

We suggest a clarification to better reflect the role of the control functions, in alignment with the independence principle of the control functions, as follows:

ESMA Proposed Language	Moody's Ratings Suggestion
The supervised entity's risk assessment methodology should encompass all business lines and IC Functions of the supervised entity.	The supervised entity's risk assessment methodology should encompass all business lines **and be informed by findings from the** ~~**and**~~ IC Functions of the supervised entity.

c. Component 1.3.1, Segregation of duties, pages 16 and 42

We suggest reintroducing the qualifier of "solely", in alignment with the equivalent section of the 2020 Guidelines and for consistency with footnote 33. The amendment would read as follows:

ESMA Proposed Language	Moody's Ratings Suggestion
The supervised entity should ensure appropriate segregation of duties to manage risks of conflicts of interest, fraud and human error. The segregation of duties should ensure that: i. Staff members responsible for carrying out a task are not responsible for approving the outcome of its exercise; ii. Staff members responsible for the development, implementation or approval of a task/work item are not responsible for validating, assessing and reviewing it. Where this cannot be avoided, this should be mitigated by these staff members not being exclusively responsible for the activity.	The supervised entity should ensure appropriate segregation of duties to manage risks of conflicts of interest, fraud and human error. The segregation of duties should ensure that: i. Staff members responsible for carrying out a task are not **solely** responsible for approving the outcome of its exercise; ii. Staff members responsible for the development, implementation or approval of a task/work item are not responsible for validating, assessing and reviewing it. Where this cannot be avoided, this should be mitigated by these staff members not being exclusively responsible for the activity.

d. Component 1.3.1, Segregation of duties, footnote 18 on page 16 and footnote 33 on page 42

We consider the newly proposed language overly restrictive, and it is not clear why ESMA seeks to change the substance of these provisions, which were substantively discussed in the development of the 2020 Guidelines.

It should not be assumed that any degree of overlapping responsibilities among staff members necessarily implies a conflict of interest. Rather, the involvement of a person who has previously reviewed or validated a methodology in the decision-making process for approval enriches the debate and adds additional understanding of the methodology, while the requirement that such a person is not solely responsible builds in sufficient safeguards.

Similarly, attendance at rating committees by analytical staff involved in the development of a rating methodology can be helpful. Such experience can provide analytical staff with valuable insight into the practical application of the rating methodologies and can serve training purposes. In other instances, rating committees may be assisted by having members of the methodology development group present in the committee to provide specific expertise. We do not believe that such interaction should be precluded per se.

Note that ESMA proposed the same language as in the present Consultation Paper in its 2020 Consultation Paper on Internal Controls for CRAs but decided to change it for the final 2020 Guidelines, in recognition of these concerns[1].

We suggest reinstating the existing requirement, which is proportionate and well understood:

[1] See "Final Report – Guidelines on Internal Controls for CRAs", ESMA33-9-371, paragraph 15 on pages 7-8 and paragraph 24 on pages 9-10.

ESMA Proposed Language	Moody's Ratings Suggestion
For CRAs, (i) persons conducting the analysis of a credit rating should not be solely responsible for the approval of the credit rating, (ii) persons responsible for the development of credit rating methodologies should not be involved in their implementation; (iii) persons responsible for the validation, assessment or review of a credit rating methodology should not be involved in their development, implementation or approval.	For CRAs, (i) persons conducting the analysis of a credit rating should not be solely responsible for the approval of the credit rating, (ii) persons responsible for the development of credit rating methodologies should not be **solely responsible for their approval** ~~**involved in their implementation**~~; (iii) persons responsible for the validation, assessment or review of a credit rating methodology should not be **solely responsible for the approval of the validation, assessment or review** ~~**involved in their development, implementation or approval**~~.

e. Component 1.3.3, Documented Controls and Control Testing, pages 16 and 42

For proportionality, we suggest reintroducing the materiality provision in subpoint (ii), as present in the 2020 Guidelines. This also aligns with applicable Guidelines in related sectors (EBA Guidelines on internal governance under the CRD and EIOPA Guidelines on system of governance):

ESMA Proposed Language	Moody's Ratings Suggestion
The supervised entity should document the key controls in place to ensure adherence to its policies and procedures relevant to the Regulations. The documentation of these controls should set out: i. A description of the control ii. The associated risk(s) iii. The role(s) or functions(s) responsible for performing the control iv. The role(s) or functions(s) responsible for reviewing the control v. The evidence that the control has been executed vi. The frequency of execution of the control vii. A description of the testing procedure	The supervised entity should document the key controls in place to ensure adherence to its policies and procedures relevant to the Regulations. The documentation of these controls should set out: i. A description of the control ii. The associated **material** risk(s) iii. The role(s) or functions(s) responsible for performing the control iv. The role(s) or functions(s) responsible for reviewing the control v. The evidence that the control has been executed vi. The frequency of execution of the control vii. A description of the testing procedure

f. Component 1.4.2, Information and Communication, pages 19 and 44

For proportionality, we suggest reinstating the materiality provision as present in the 2020 Guidelines, as follows:

ESMA Proposed Language	Moody's Ratings Suggestion
The supervised entity should establish upward communication channels, including a whistleblowing procedure, to enable the escalation of internal control issues to the Management Body and executive senior management. The Management Body and executive senior management should also receive regular updates about the internal control system and activities, including on information security. The supervised entity should have escalation procedures in case of disagreement between IC Functions and operating units.	The supervised entity should establish upward communication channels, including a whistleblowing procedure, to enable the escalation of **material** internal control issues to the Management Body and executive senior management. The Management Body and executive senior management should also receive regular updates about the internal control system and activities, including on information security. The supervised entity should have escalation procedures in case of disagreement between IC Functions and operating units.

g. Component 1.4.3, Information and Communication, pages 19 and 44

We believe the Management Body should have an oversight function but should not be involved in day-to-day operations, such as communications with staff. We suggest an amendment that also brings the text in line with the 2020 Guidelines, as follows:

ESMA Proposed Language	Moody's Ratings Suggestion
The supervised entity should establish downward communication channels from the Management Body, executive senior management and control functions to the staff. This should encompass regular updates on the objectives and responsibilities for internal control, communication of identified compliance or information security issues and presentations and training on policies and procedures.	The supervised entity should establish downward communication channels from ~~**the Management Body,**~~ executive senior management and **the** control functions to the staff. This should encompass regular updates on the objectives and responsibilities for internal control, communication of identified compliance or information security issues and presentations and training on policies and procedures.

h. Component 1.5.6, Monitoring Activities, pages 21 and 45

For proportionality and in alignment with the 2020 Guidelines, we suggest that this requirement should be subject to a materiality provision. For CRAs, this is also in alignment with Article 9 of the CRA Regulation:

ESMA Proposed Language	Moody's Ratings Suggestion
In the case of outsourcing, the supervised entity should allocate the task for monitoring outsourced business processes to a member of staff. Supervised entities should ensure that sufficient information concerning objectives and delivery expectations is provided to the service provider, and that	In the case of outsourcing **of important operational functions**, the supervised entity should allocate the task for monitoring outsourced business processes to a member of staff. Supervised entities should ensure that sufficient information concerning objectives and delivery expectations is provided to the service provider, and that

due diligence is conducted prior to the appointment of the provider.	due diligence is conducted prior to the appointment of the provider.

Q2: Are there any other comments you wish to raise on this section?

We suggest deleting the examples provided in footnote 32 (paragraph 1.3.1, page 42). We think these examples can be read as prescribing quite rigid and specific roles, responsibilities and organisational structures, which is unnecessary and overly restrictive. It also risks cementing business practices and puts ESMA at risk of prescribing to supervised entities how operational practices should be managed. We think it is sufficient and more proportionate for the guidelines to set out the principles that relevant entities need to follow, and allow these to be applied with a degree of flexibility that reflects each firm's specificities.

ESMA Proposed Language	Moody's Ratings Suggestion
For instance, staff members in charge of carrying out business requirements analysis activities or responsible for conducting commercial / business development activities should not be involved in client / regulatory support activities. In addition, staff members responsible for system development activities should not be involved in database administration, IT operations, and IT systems and network administration and maintenance.	~~For instance, staff members in charge of carrying out business requirements analysis activities or responsible for conducting commercial / business development activities should not be involved in client / regulatory support activities. In addition, staff members responsible for system development activities should not be involved in database administration, IT operations, and IT systems and network administration and maintenance.~~

Question 3. Do you have any comments on the proposed Guidelines under this section on IC Functions? In providing your comments, please refer to the general principle, component and/or characteristic that you are commenting on.

We suggest amendments in three areas:

a. **Section 4.2, Internal Control Functions, paragraph 18 – General Principles, pages 21 and 46**

We suggest modifications that provide greater flexibility to the role assigned to the Management Body in different firms; in particular for complex global organisations with different subsidiaries that each have their own management body. We further suggest a clarification to the extent that this requirement pertains to the function, rather than any individual staff members. We also suggest introducing the materiality provision of "important" operational tasks, as present in the 2020 Guidelines:

ESMA Proposed Language	Moody's Ratings Suggestion
ESMA considers that supervised entities' IC functions should have sufficient resources and be staffed with individuals with sufficient expertise to discharge their duties. Staff working in IC Functions should have sufficient technical knowledge of the supervised entity's activities and the	ESMA considers that supervised entities' IC functions should have sufficient resources and be staffed with individuals with sufficient expertise to discharge their duties. Staff working in IC Functions should have sufficient technical knowledge of the supervised entity's activities and the

associated risks. Where a supervised entity has outsourced the operational tasks of an IC function to group level or to an external party, ESMA considers that the supervised entity retains full responsibility for the activities of the outsourced IC function. Supervised entities should ensure that staff in charge of IC functions should be of an appropriate seniority to have the necessary authority to fulfil their responsibilities. For example, staff members in charge of the compliance, risk management, internal audit, information security, review (for CRAs) and oversight (for BAs) functions should be directly accountable to the Management Body and their performance should be reviewed by the Management Body.	associated risks. Where a supervised entity has outsourced the **important** operational tasks of an IC function to group level or to an external party, ESMA considers that the supervised entity retains full responsibility for the activities of the outsourced IC function. Supervised entities should ensure that staff in charge of IC functions should be of an appropriate seniority to have the necessary authority to fulfil their responsibilities. For example, ~~**staff members in charge of**~~ the compliance, risk management, internal audit, information security, review (for CRAs) and oversight (for BAs) functions should **provide reports** ~~**be directly accountable**~~ to the Management Body and **be subject to its challenge** ~~**their performance should be reviewed by the Management Body**~~.

b. Section 2.4.1, pages 29 and 50

The expectation that Internal Audit performs its functions independently from other internal control functions is new, compared to the 2020 Guidelines. It could be read to preclude an "aligned assurance" model in which the lines of defence can rely upon each other's findings, subject to satisfying themselves of the robustness of the approach followed. Aligned assurance is a well-established concept that seeks to promote an interconnected and comprehensive approach to risk management, and we suggest a clarification to acknowledge its validity.

See for example: Enterprise Risk Management | Compliance Risk Management: Applying the COSO ERM Framework, November 2020: "For each high-priority compliance risk, in addition to developing an education and training strategy, the organization should develop a monitoring and auditing plan. Although the compliance function may take the lead in the development of such plans, it should not be the responsibility of compliance alone. Risk owners, internal audit, risk management, and potentially others should be involved in developing the plan. Role clarification for the plan is essential to minimize duplication of effort and assurance gaps. The plan should include a description of the planned risk responses, who is responsible for the response, how response effectiveness is measured, and who will be responsible for the performance review."

ESMA Proposed Language	**Moody's Ratings Suggestion**
The internal audit function should perform its functions independently of the business lines and other IC Functions. It should be governed by an internal audit charter that defines its role and responsibilities and is subject to oversight by the Management Body.	The internal audit function should perform its functions independently of the business lines and other IC Functions. **This does not preclude acceptance of the testing results of other IC functions in an "aligned assurance" model.** It should be governed by an internal audit charter that defines its role and responsibilities and is subject to oversight by the Management Body.

c. Section 2.4.3, pages 29 and 50

For proportionality and in alignment with the 2020 Guidelines, we suggest that this requirement should be subject to a materiality provision. For CRAs, this is also in alignment with Article 9 of the CRA Regulation. We suggest an amendment as follows:

ESMA Proposed Language	**Moody's Ratings Suggestion**
The internal audit function should independently review and provide objective assurance that the supervised entity's activities, including outsourced activities, are in compliance with the supervised entity's policies and procedures as well as with applicable legal and regulatory requirements.	The internal audit function should independently review and provide objective assurance that the supervised entity's activities, including **management's control over** outsourced ~~**activities**~~ **important operational functions**, are in compliance with the supervised entity's policies and procedures as well as with applicable legal and regulatory requirements.