European Commission
Rue de la Loi, 200
1040 Brussels
Belgium

8 June 2022

Dear Madam or Sir

Targeted consultation on the functioning of the ESG ratings market in the European Union and on the consideration of ESG factors in credit ratings

Fitch appreciates the opportunity to respond to the European Commission's consultation on ESG ratings and ESG factors in credit ratings. We have provided detailed answers to many of the questions in the consultation via the online response form. This letter is therefore intended to highlight the key themes that underlie many of these responses and to provide additional feedback that does not necessarily fit into a response to any specific question.

ESG factors in credit ratings

Fitch Ratings has always incorporated ESG factors into credit ratings where they are relevant. We also recognise that in recent years users of credit ratings have increasingly wanted a better understanding of when and how individual credit ratings have been affected by ESG factors. This is why we introduced our ESG Relevance Scores (ESG.RS) in early 2019. ESG.RS were developed before ESMA produced its ESG disclosure guidelines and go beyond the scope of those guidelines, demonstrating the importance that Fitch Ratings places on informing the market about the role of ESG in credit ratings.

However, Fitch Ratings is concerned about the direction and implications of some of the questions in this consultation and in particular the suggestion that the European Commission could place ESG-related requirements on the content of CRAs' methodologies.

On the face of it, the suggestion that CRAs could be required to "take into account ESG factors where relevant" does not seem onerous, as Fitch Ratings has always done so and clearly indicates where an ESG factor is relevant via its ESG.RS. But interference in methodologies in this manner is contrary to the principle that a CRA's credit rating decisions should be independent and free from political or economic pressure. This principle was enshrined in the IOSCO Statement of Principles Regarding the Activities of Credit Rating Agencies in 2003. It has been a central pillar of CRA regulation ever since, including via Article 23 of the EU CRA Regulation, which forbids the Commission, ESMA and other authorities from interfering with the content of credit ratings or methodologies.

Breaching Article 23 and the broader principle of independence would create significant risks and Fitch Ratings is concerned that the Commission does not appear to have considered these risks and has not identified them in its consultation paper. It would set a precedent for further interference in methodologies. It would also create uncertainty about who should decide whether an ESG factor is relevant and how it should be considered in methodologies. This uncertainty would open the way to guidelines or additional legislation to regulate the details of how to assess relevance, further undermining the independence of methodologies and their development by CRAs.

Fitch Ratings believes these actions would risk damaging market confidence in credit ratings and leaving investors uncertain as to whether a rating decision had been influenced by factors the CRA did not consider relevant. This would be detrimental for the Commission's Capital Markets Union initiatives and the European Green Deal objectives

In addition, direct involvement by the Commission, ESMA or other authorities in the content of credit ratings or methodologies would create the risk of moral hazard – since the legislator and ESMA would specify the contents of the methodologies, they could be seen to be endorsing and potentially liable for the credit ratings produced under these methodologies.

ESG ratings

Fitch believes introducing a European regulatory regime for ESG ratings providers would be counter-productive to the objectives of the European Green Deal. It would impose significant cost burdens on a still-young industry, which could hamper innovation and growth.

We also note that ESG ratings are very different from credit ratings in that they include a broad range of products with different intended uses and different approaches to assessing the multiplicity of factors that can determine the E, S and G aspects of an entity's activities, investments and issuances. Fitch believes this variety within ESG ratings is beneficial for the marketplace and allows users to find an ESG rating product that suits their specific needs. Regulation, no matter how carefully formulated, would risk limiting the ability of ESG ratings providers to serve these different use cases.

However, we also recognize that the multiplicity of approaches and types of ESG ratings does create a risk of confusion over what an ESG rating is assessing and whether it can be compared to an ESG rating from another provider. We believe this risk would be best addressed by the introduction of an international code of conduct for ESG ratings providers under the auspices of IOSCO, which has already laid the groundwork for such an initiative via its 2021 Final Report on ESG Ratings and Data Products Providers.

A code of conduct would set standards covering the need for transparent ESG rating definitions and methodologies and for internal procedures to ensure their consistent application, which would alleviate users' concerns over the comparability of ratings. It would also incorporate standards on identifying, managing and mitigating potential conflicts of interest, such as through structuring staff reporting lines and compensation so as to prevent any commercial influence on ESG ratings.

We believe this approach would have three key advantages over regulation at the European level: It would create a globally consistent approach, it would impose less of a cost burden on a relatively young industry while still addressing the key issues of transaparency and prevention of conflicts, and it could potentially be implemented more quickly. Together these advantages are likely to make a code of conduct more supportive of the objectives of the European Green Deal than European regulatory intervention.

Finally, we note that while the consultation states its focus is on a potential intervention specifically covering ESG ratings, it also includes questions on the use of non-rating ESG products such as controversy screening, rankings and qualitative assessments. We also note that other discussions around regulation in this space

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have sometimes incorporated these and other products under descriptions such as data products, or assessment tools.

These categories contain a much broader range of products than ESG ratings, making them even less suited to the introduction of a European regulatory regime. If the intention is to cast a wide net covering data products and qualitative assessments as well as ESG ratings then this approach is a further factor in favor of the strong argument to consider a code of conduct rather than regulation.

In addition, Fitch believes that any regulatory intervention should explicitly exclude products focussed on aggregating data or providing data feeds or tools that do not incorporate any analytical assessment or qualitative interpretation of the data, as these products do not involve the same risks around transparency and conflict management as ESG ratings.

We thank you for the opportunity to participate in this very timely debate. Should you wish to discuss further any of Fitch's responses, either in this letter or in Fitch's submission, please contact the undersigned at susan.launi@fitchratings.com.

Yours sincerely,

Susan Launi
Global Head of Regulatory Affairs, Policies and Procedures