Moody's Shared Services UK Ltd
One Canada Square
Canary Wharf
London, UK E14 5FA
+44 (20) 7772-1000
moodys.com

6 June 2022

By Electronic Submission

MOODY'S CORPORATION RESPONSE TO THE EUROPEAN COMMISSION'S TARGETED CONSULTATION ON THE FUNCTIONING OF THE ESG RATINGS MARKET IN THE EU AND ON THE CONSIDERATION OF ESG FACTORS IN CREDIT RATINGS

Moody's Corporation (**"Moody's"**) is a global integrated risk assessment firm, providing data, analytical solutions and insights to help decision-makers identify opportunities and manage the risks of doing business with others.

We would like to thank the European Commission for the opportunity to provide comments in respect of the functioning of the environmental, social and governance (**ESG**) ratings market in the EU and in respect of the consideration of ESG factors in credit ratings. We respond in respect of both parts of the consultation document. Specifically:

- Moody's Investors Service (**MIS**), the credit rating agency, integrates environmental, social and governance (**ESG**) considerations into its credit ratings and credit research.

- Moody's ESG Solutions (**MESG**) provides ESG Measures, Climate Solutions and Sustainable Finance solutions.

We wish to thank the Commission for its clear characterisation and distinction between credit ratings and ESG ratings. As outlined by the Commission:

- **Credit ratings** are forward-looking opinions about the relative credit risks of an issuer or a debt instrument, using an established and defined ranking system. There is a consensus in the market as to their very specific purpose and the measurement of rating quality.

- **ESG ratings** refer to a broad spectrum of products that provide an opinion regarding an entity, a financial instrument or a product, a company's ESG profile or characteristics or exposure to ESG, climatic or environmental risks or impact on society and the environment that are issued using a defined ranking system of rating categories. There is no one "correct" or widely accepted answer as to what ESG ratings should seek to measure, how to weigh off different aspects of ESG against each other, and how to assess the quality of ESG ratings.

It is, therefore, appropriate to consider both in their own right and appreciate the specifics of each product or range of products. As we set out in the following, we see a case for the introduction of a proportionate, principles-based legislative framework for ESG ratings. In contrast, credit ratings are already subject to a comprehensive regulatory framework in the EU and in most major jurisdictions around the world. We do not believe that further legislative action is warranted in respect of credit ratings.

1. We support a legislative framework for ESG ratings that is fundamentally principles-based and focused on transparency and integrity.

    a. Diversity in the market for ESG ratings is healthy and not indicative of a market failure.

We appreciate the significance that policy-makers attribute to the market for ESG ratings and take note of the European Commission's considerations in respect of possible concerns that may hamper the further development of this market, in section II on the "Functioning of the ESG ratings market". However, the market for ESG ratings is nascent and evolving rapidly. We believe that diversity is a natural and healthy characteristic at this stage of the market's development, and not indicative of a market failure. There is a growing presence of both established financial players and relatively new start-ups, all seeking to develop decision-useful data, analytics and insights for a broad stakeholder base.[1]

The heterogenous needs of end-users are leading to a broad spectrum of distinct products and solutions that capture either aggregated ESG factors or individual issues (such as human rights); weigh human intervention and machine-driven analytical processes differently; or incorporate different approaches to materiality (single versus double[2]). Diversity across ESG rating providers also results from different points of view as to how well a company manages trade-offs between the needs and expectations of different stakeholders, including communities, customers, employees, creditors and shareholders. Different ESG tools may be complementary or may serve discrete functions in the market.

We consider that a single provider's ESG ratings should be coherent against each other, but need not be comparable to products of other providers. Given the diversity of approaches, ESG ratings on the same issuer might well diverge between different providers, even if at a high level, they seek to measure the same sustainability aspects.

Investors and other users of ESG ratings will decide which approach best suits their own investment philosophy, based on an assessment of the merits of different ESG providers. The market will mature in this process. Over time and in conjunction with ongoing data improvements, there may be a development towards greater correlation of the ESG ratings of different providers. It is, however, equally possible that the market evolves otherwise. For example, certain providers might specialise in certain sectors or asset classes.

    b. We support a legislative framework that remains fundamentally principles-based and focuses on core principles of transparency and integrity.

We believe that a properly calibrated legislative framework can be supportive of market development, provided it focuses on creating an environment of high integrity and transparency. In contrast, a framework that is overly prescriptive and inflexible could inadvertently stifle innovation in products and services or might impose solutions that do not respond adequately to complex and diverse customer

---

[1] As pointed out by the Global Sustainable Investment Alliance's, "Global Sustainable Investment Review 2020", the sustainable investment industry continues to grow rapidly, with sustainable assets under management reaching a record $35.3 trillion in 2020. However, the industry remains in transition, with rapid developments across regions that are reshaping sustainable investment.

[2] MESG uses a double materiality approach.

needs. For example, an approach that applies the level of oversight and control as required by the Credit Rating Agencies (CRA) Regulation[3] to the ESG market would be too onerous.

We suggest instead that any framework contemplated for ESG ratings and data products providers remains fundamentally principles-based in nature at this stage of the industry's evolution and focuses on core principles of transparency of methods and integrity of process. Specifically, we see merit in rules that require: (i) transparency on the objective of ESG ratings, methodologies applied, and sources of underlying data; and (ii) a demonstration as to how ESG rating providers address perceived or actual conflicts of interest.

Critically, in order to establish market credibility, we suggest that any framework enshrine the necessary independence of methodologies and ratings. Specifically, we do not believe that ESG methodologies should be standardised. Different types of ESG methodologies and ESG ratings should be allowed and encouraged to co-exist and to provide alternative approaches and views.

c. The sustainable finance market is best served by continued regulatory efforts to improve ESG-relevant data and issuer disclosures.

We believe that the market for ESG ratings is best served by regulatory efforts that focus on enhancing the availability, quality and comparability of underlying data and inputs. If successfully implemented, harmonisation of ESG and climate disclosure would lead to more robust, useful inputs for end-users, including ESG ratings and data product providers.

We welcome ongoing efforts in the EU and internationally to this effect. This includes in particular the proposed Corporate Sustainability Reporting Directive in the EU and the ongoing work by the International Sustainability Standard Board (ISSB) to consolidate and further develop global sustainability reporting standards. Greater harmonisation of ESG data will provide a clearer starting point from which ESG ratings and data product providers can base their analysis and research. Investors, in turn, will benefit from improved confidence in ESG-relevant data and from the additional clarity around ESG products, facilitating their choice of ESG assessment provider.

2. We do not see a need for further legislative action in respect of credit ratings.

We thank the European Commission for its thorough consideration of the context to its questionnaire; in particular, in respect of the role of CRAs, the existing high level of regulation in the EU and globally, and the European Securities and Markets Authority's (ESMA) ongoing work to consider ESG considerations in credit ratings. As the Commission rightly points out, CRAs serve a very specific role in the market and seek to address an important, but narrow, question in respect of an entity's or financial instrument's creditworthiness. This market is mature, well understood, and highly regulated.

At Moody's, we have always taken account of ESG considerations in our credit ratings, where materially relevant to credit. Over the past several years we have undertaken a great amount of work to provide greater transparency in respect of the credit implications of ESG considerations. This has been driven by our efforts to meet the needs of our customers but has also aligned with, and augmented by, ESMA's Guidelines on disclosure requirements applicable to credit ratings[4]. Our efforts have included:

- the introduction of a cross-sector methodology on our approach to ESG in credit ratings;

[3] Regulation (EC) No 1060/2009 on credit rating agencies, as amended.
[4] ESMA33-9-320: Final Report, "Guidelines on Disclosure Requirements Applicable to Credit Ratings", 18 July 2019.

- the publication of heat maps that identify the sectors most exposed to "E" and "S" risks and specify material risks for each sector;
- and most recently, the introduction of Issuer Profile Scores and Credit Impact Scores that speak to the impact of E, S and G considerations, individually and collectively, on an issuer's credit profile.

We have been in regular engagement with ESMA to discuss our evolving analytical approach, as part of our normal supervisory relationship, and continue to develop our thinking in ongoing engagement with ESMA. ESMA can build on an extensive toolkit for this purpose.

We also observe that ESMA's assessment of the implementation of its Guidelines on the disclosure of ESG factors in credit rating press releases,[5] as cited by the European Commission, does not indicate non-compliance with the Guidelines on the part of CRAs. ESMA's own policy conclusions also do not identify the need for legislative amendments. Instead, they indicate ESMA's intention to consider the appropriate supervision and policy tools to achieve further transparency and to further engage with CRAs in order to understand the underlying drivers of the observed heterogeneity and to ensure that the Guidelines are implemented in a consistent manner.[6]

We thank you for your consideration and remain at your disposal to discuss our response.

Yours sincerely,

/S/ Nick Miller

Nick Miller
Managing Director, Global Regulatory Affairs

[5] ESMA 80-195-1352: Trends, Risks and Vulnerabilities Report, 10 February 2022: Text mining ESG disclosures in rating agency press releases.
[6] See ESMA 80-195-1352, p. 12.