

# Final Report

Technical Advice on Revisions to Commission Delegated Regulation (EU) 447/2012 and Annex I of CRA Regulation

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## 1 Executive Summary

### Reasons for publication

On 2 April 2024 ESMA published a consultation paper proposing amendments to Commission Delegated Regulation (EU) No 447/2012 and Annex I of Regulation 1060/2009 on Credit Rating Agencies. The objective of these amendments was to ensure the better traceability on the incorporation of ESG factors in credit rating methodologies and better disclosure of the relevance of ESG factors to individual credit rating actions. The proposals contained within the consultation paper were provided in response to a formal request for technical advice received from the European Commission in June 2023. The proposals respond also to the need to update a number of provisions of Commission Delegated Regulation (EU) No 447/2012 to reflect ESMA's supervisory observations. Following the conclusion of the consultation process ESMA has introduced revisions to its proposed technical advice. This Final Report provides ESMA's proposals for amending:

- Commission Delegated Regulation (EU) No 447/2012;
- Annex I of Credit Rating Agencies Regulation;

### Contents

The main body of this Final Report (Section 2) provides an overview of the feedback received to the consultation conducted by ESMA and explains how this feedback has been considered in developing the final technical advice, in addition:

- Annex I provides the Legislative Mandate for ESMA's Technical Advice
- Annex II provides the updated Cost Benefit Analysis
- Annex III provides ESMA's proposed amendments to Commission Delegated Regulation (EU) No 447/2012 and Annex I of the CRA Regulation.

### Next Steps

ESMA will publish this Final Report on the ESMA website and transmit the technical advice included in this Final Report to the European Commission.

## 2 Overview

### 2.1 Background

1. The regulatory framework for EU credit rating agencies was established in 2009 with the introduction of the CRA Regulation (Regulation (EC) 1060/2009 on credit rating agencies<sup>1</sup>). The regulatory framework has since been subject to two significant revisions,

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<sup>1</sup> [Regulation \(EC\) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies \(Text with EEA relevance\)](#)

first in 2011<sup>2</sup> (“CRA2”) to reflect the assumption of supervisory responsibilities by ESMA and then in 2013<sup>3</sup> (“CRA3”) to introduce new provisions.

2. The CRA Regulation sets out detailed requirements to protect against conflicts of interest, ensure robust methodologies and sound corporate governance and deliver transparency to investors and the market. The supporting regulatory framework is composed of several Regulatory Technical Standards and Delegated Acts which provide further detail on the functioning of certain key provisions within the CRA Regulation. In addition, ESMA promotes the smooth functioning of this regulatory framework through the development and implementation of Guidelines and Questions and Answers.
3. When it comes to delivering transparency to the market and to investors, Annex I of the CRA Regulation sets out detailed requirements for CRAs’ credit rating and methodological disclosures. The purpose of these provisions is to enable investors and users of credit ratings to have all relevant information necessary to understand a credit rating and perform their own due diligence.
4. To ensure that credit rating methodologies meet the requirements of the CRA Regulation, the regulatory framework includes a specific Delegated Act that provides greater level of detail on how a credit rating agency can demonstrate that its credit rating methodology is rigorous, systematic, continuous and subject to validation.
5. The input on revisions to the Delegated Act and the Annex I of the CRA Regulation that is provided in this technical advice is building on several prior steps taken by ESMA. Specifically, as part of Action 6 under the European Commission’s 2018 Action Plan on Sustainable Finance, ESMA published its Guidelines on Disclosures applicable to Credit Ratings.
6. These Guidelines had the objective of improving the consistency and transparency of credit rating agencies’ press releases. The Guidelines also sought to improve the level of transparency provided when ESG factors were a key driver behind a credit rating or rating outlook.
7. As part of Action 3(b) of the European Commission’s Sustainable Finance Strategy, ESMA conducted a Thematic Review on the integration of ESG factors in CRA’s methodologies. This thematic review was concluded by Q2 2022. In addition, as part of Action 3(b) ESMA assessed the implementation of the Guidelines on Disclosure, with respect to whether the disclosure on the relevance of ESG factors had improved.
8. In addition to the tasks allocated to ESMA under European Commission’s Sustainable Finance Strategy, Action 3(b) also required that, subject to ESMA’s findings, the European Commission would take action to ensure that relevant ESG risks are systematically captured in credit ratings and improve transparency on the inclusion of ESG risks by credit rating agencies in credit ratings and rating outlooks<sup>4</sup>.

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<sup>2</sup> [Regulation \(EU\) No 513/2011 of the European Parliament and of the Council of 11 May 2011 amending Regulation \(EC\) No 1060/2009 on credit rating agencies Text with EEA relevance](#)

<sup>3</sup> [Regulation \(EU\) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation \(EC\) No 1060/2009 on credit rating agencies Text with EEA relevance](#)

<sup>4</sup> [COM\(2021\) 390 final - ANNEX to the COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, Strategy for Financing the Transition to a Sustainable Economy, Action 3\(b\).](#)

## 2.2 Commission Request for Technical Advice

9. The European Commission submitted a request for Technical Advice to ESMA in June 2023 seeking input on amendments to the CRA Regulatory Framework.
10. In line with the European Commission's own deliverable under Action 3(b), this request for technical advice sought ESMA's assessment on how Annex I of the CRA Regulation and Commission Delegated Regulation (EU) No 447/2012 (the Delegated Regulation on Methodologies) could be updated in order to ensure a better incorporation of ESG factors in the methodologies and rating process and the further disclosure to the public. This request for technical advice is included in Annex II.

## 2.3 Public Consultation Process

11. On 2 April 2024, ESMA published a Consultation Paper (CP) providing ESMA's input on amendments to Commission Delegated Regulation (EU) 447/2012 and Annex I of the CRA Regulation. The period of consultation closed on 21 June 2024.
12. ESMA received 19 responses, of which three were confidential. Responses were received from a range of stakeholders including credit rating agencies, industry associations and other financial market participants. The breakdown of respondents was 9 responses from credit rating agencies and 10 from industry associations, investment funds, banking, insurance and pensions funds<sup>5</sup>.
13. Respondents to the CP were generally supportive of the objectives of the revisions to Commission Delegated Regulation 447/2012 and Annex I of the CRA Regulation. At the same time respondents provided a significant number of comments on how these objectives might be achieved through other means.
14. Based on these observations, the Feedback Statement presented in this Final Report summarises the key points raised by respondents and how this feedback has been taken into account in the final technical advice.
15. In line with Article 10 of the ESMA Founding Regulation, ESMA consulted the Securities and Markets Stakeholder Group (SMSG) on the proposed draft technical standards. The SMSG decided not to provide advice to ESMA on the RTS/ Annex. In developing and finalising the technical advice on Commission Delegated Regulation 447/2012 ESMA has also consulted EBA and EIOPA in line with Article 21(7) of EU Regulation 1060/2009.

## 2.4 Feedback Statement

### 2.4.1.1 Overview of Responses

16. Responses received to the public consultation were generally clustered around a small number of areas such as the prescriptiveness of ESG integration in methodologies, the

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<sup>5</sup> Non-Confidential Responses can be found on ESMA's website at the following location: <https://www.esma.europa.eu/press-news/consultations/consultation-possible-amendments-credit-rating-agencies-regulatory>

introduction of a term as to what constitutes a methodology and the expansion of scope to include rating outlooks. This input and ESMA's overall response can be summarised as follows:

- Overall, most respondents agreed with ESMA's objective of delivering transparency around the consideration of ESG factors in credit rating methodologies. In this regard, there was broad support for the proposed changes to Annex I of the CRA Regulation.
  - At the same time, many respondents cautioned against ESMA proposing an overly prescriptive approach to the integration of ESG factors in the Delegated Regulation. Respondents also questioned the need for identifying and categorising, where applicable, each factor in a credit rating methodology as E, S, G.
  - Respondents generally put forward that such an approach would require significant changes to credit rating agencies methodological processes and could be interpreted as interference in credit rating methodologies.
  - Some respondents also expressed concern that establishing what would be understood as a credit rating methodology for the purpose of Delegated Regulation 447/2012 would exceed ESMA's legislative mandate. Moreover, ESMA was called to avoid proposing a mandatory closed-end framework of a credit rating methodology.
  - Respondents were also concerned about the proposed approach of including rating outlooks within the scope of Delegated Regulation 447/2012. In their view this constituted an expansion in scope of the regulatory framework beyond the CRA Regulation which could be interpreted as placing rating outlooks on the same legal footing as credit ratings across all provisions.
  - There was general support among respondents with regards to ESMA's enhancing the requirements on the systematic application of methodologies.
  - Most respondents did not object to ESMA's proposal to improve aspects around the validation of a credit rating methodology but requested more clarity on ESMA's rationale in this regard.
  - Overall, there was general support for the disclosure of information of credit rating agencies' process for the validation of credit rating methodologies as well as for clarifying that the latter task should fall under the responsibility of the review function.
  - More generally, there was broad support for ESMA's proposals to amend Annex I of the CRA Regulation, with limited comments or revisions suggested.
17. **ESMA Response:** ESMA has taken the views of respondents into account in the final proposal. This has involved reflecting on the appropriate level of prescriptiveness on the integration of ESG considerations in credit rating methodologies. ESMA has accordingly adjusted its proposals to the Delegated Regulation while maintaining the initial rationale as regards the disclosures in Annex I of the CRA Regulation. ESMA has also adjusted how rating outlooks are captured by the Delegated Regulation to avoid unintended consequences in the application of other aspects of the regulatory framework. Concerning what is considered to constitute a credit rating methodology, ESMA has not opted for a closed-end approach but has instead clarified the basis according to which it would examine overall compliance under the relevant legal empowerment. ESMA has adjusted its approach for disclosure in Annex I of the CRA Regulation only in so far as needed to align with the revised proposals for the integration of ESG considerations in Delegated Regulation 447/2012. Minor changes have been made to proposals for disclosure of validation processes.

#### 2.4.1.2 Reference to “rating outlooks” (Questions 1, 2, 5-8)

18. While respondents recognized the relevance of updating Delegated Regulation 447/2012 to include reference to rating outlooks, a large number disagreed with the approach of adding reference to 'rating outlooks' alongside each reference to “credit rating” in the Delegated Regulation. One of the key concerns for respondents was that such an approach would compel CRAs to apply the Delegated Act in a uniform manner to both credit ratings and rating outlooks. In this regard, it was acknowledged that while the revisions introduced by CRA3 extended the scope of the CRA Regulation to rating outlooks, this extension did not encompass all of the CRA Regulation's requirements. In this regard, respondents underlined specific instances where a reference to rating outlooks would not be appropriate, such as Article 7 of the Delegated Regulation. Furthermore, respondents pointed to the clear differences in how CRAs view a rating outlook versus a credit rating from the perspective of an analytical output.
19. On this basis, the view of respondents was that maintaining this approach would introduce substantial operational challenges for credit rating agencies and could unintentionally expand the scope of the CRA Regulation beyond what was foreseen with the revisions introduced by CRA3. It was added that these difficulties would be further aggravated by the proposed specification of the term “methodologies”.
20. **ESMA Response:** In ESMA's view it is important that the content of Delegated Regulation 447/2012 is fully aligned with the scope of the CRA Regulation. At the same time, ESMA recognises that it is not necessary for each provision directed at credit ratings to be applied to 'rating outlooks' and that there are instances where it is reasonable to distinguish between the two outputs, for example in cases of validation. Taking this into account, ESMA has revised its proposed amendments to Delegated Regulation 447/2012 to remove specific references to rating outlooks from Articles 4-7 of the Commission Delegated Regulation 447/2012, on the basis that these Articles are concerned with the specifics of how methodologies are used to determine credit ratings and a direct reference to “rating outlooks” would not be relevant to all of these processes. At the same time, ESMA has included reference to 'rating outlooks' in Article 3(2)(c) to make clear that when examining the ongoing compliance of credit rating agencies with the provision of Article 8(3) of the CRA Regulation ESMA will consider that the requirements applicable to credit ratings apply, where relevant, to rating outlooks as well.

#### 2.4.1.3 Clarification of the term “Methodology” (Questions 1-2)

21. A recurrent area of disagreement among respondents concerned the inclusion of text in Articles 1 and 3 that established what was understood to constitute a “credit rating methodology”, for the purposes of Delegated Regulation 447/2012. In this respect, respondents considered that the introduction of this clarification exceeded the scope of the European Commission's request for Technical Advice and raised concerns regarding methodological independence in respect of Article 23 of the CRAR.
22. Respondents highlighted the following concerns around the introduction of this clarification; (i) it would create difficulties for CRAs by requiring a uniform application across all credit rating methodologies (ii) it had the potential to introduce inconsistencies between the “level one” and “level two” understanding of the term on the basis that the



CRA Regulation does not include such a term (iii) the fact that for some credit rating agencies driving factors, key rating assumptions and models can be potential components of a methodological framework rather than parts of a closed-end list. Regarding the final point, respondents were, respectively, opposed to the deletion of “*where these are in place*” from Article 4 (1)(d) on the basis that such a deletion would in their view imply a compulsory closed-end set of components in methodologies and could also be understood as undermining methodological independence. Along the same lines, respondents pointed to the need to revert to the initial wording of Article 5(1). Finally, the need to omit reference to rating outlooks from the scope of what was determined by a methodology was also repeatedly underlined in respondents’ proposals, on the basis that a rating outlook is an opinion on the direction of a credit rating.

23. In general, respondents were aligned in their request for ESMA to adopt a more flexible approach in the specification of the term “methodology”.

24. **ESMA response:** In view of the above feedback ESMA has revised its proposals and removed reference to the term “methodology” from Article 1 of Delegated Regulation 447/2012. This has been removed on the basis that the role of Article 1 is to establish what would be understood to mean “methodology” in all subsequent Articles of the Delegated Regulation, which was considered overly prescriptive. Reference to the term is however maintained in Article 3 on the basis that this sets the list of elements that ESMA will refer to when assessing whether a credit rating agency’s methodology is meeting the requirements of Article 8(3) of the CRA Regulation. Finally, ESMA has reformulated the reference in Article 3 of the Delegated Regulation by clarifying that a credit rating methodology is “the framework used for the determination of a credit rating, including, where applicable, criteria, models, driving factors and key rating assumptions relevant to the creditworthiness assessment”.

#### 2.4.1.4 ESG considerations in CRAs methodologies and subsequent disclosure to the public (Question 4)

25. Respondents generally supported the objective of raising awareness around the relevance of ESG considerations to default risk analysis amid heightened interest from market participants and regulators. Most respondents supported the need to enhance visibility on these considerations citing their adherence to, and implementation of, ESMA’s 2019 Guidelines on Disclosure.

26. However, despite support for the general objective, a number of specific objections were raised with respect to how ESMA proposed to ensure transparency on the integration of ESG factors in credit rating methodologies, specifically in Article 4(2) of the Commission Delegated Regulation 447/2012. This included strong demands from respondents for ESMA to propose a more flexible approach. A more granular breakdown of feedback received on this topic is as follows:

- Respondents strongly cautioned against disproportionately emphasising the relevance of ESG considerations to credit ratings, which could be the case if credit rating agencies were required to categorise standard credit factors as ‘E’, ‘S’ or ‘G’ factors.



- It was also argued that requiring CRAs to label components of analysis contained within their methodologies as being either an E, S or G factor, when they are not designed for that purpose, could mislead users of credit ratings without providing much insight. It could also risk creating significant market confusion, including as to the fundamental meaning of credit ratings as opposed to ESG ratings as this is under development under another EU legislative mandate. In this regard, respondents stressed that CRAs would be asked to quantify and back-test ESG factors, whereas even providers of ESG ratings may face less demanding requirements. Respondents also pointed that still there is a lack of consistent or high quality ESG data.
- A number of respondents stressed that ESG considerations are only included in the credit assessment if they are relevant to the issuer's creditworthiness or have an impact on asset quality. To provide some context to their relevance, a respondent indicated that their experience to date has shown that ESG factors usually have little to no relevance on the performance of the credit portfolio.
- In addition, respondents emphasized that not all CRAs' methodologies distinctly identify and label each quantitative and qualitative factor as an E, S or G factor. Conversely, in the consideration of ESG issues, CRAs may use a holistic or integrated approach, e.g., across sectors. ESMA's proposal could instead imply that the impact of ESG can always be isolated and extracted from other credit drivers, contrary to current experience and analysis. Similarly, a potential requirement to classify all rating drivers as either E, S or G could interfere with the primary analytical focus on credit quality and would conflict with the CRA Regulation. As a general remark, respondents pointed to the need to adopt a formulation that would allow for this flexibility in methodologies at least by adopting a "where relevant" approach in these proposals.
- In addition, it was stressed that there are still definitional challenges surrounding ESG considerations as well as a lack of global market consensus in this area. This could create arbitrary classifications of E, S and G factors in CRA methodologies. Furthermore, it was argued that the proposed wording requires the separate identification of E, S and G factors, whereas credit ratings may be influenced by a mix of such E, S and G factors (with some agencies potentially using a combined ESG score feeding into the credit rating analysis). ESMA was also invited to maintain a wording similar to the Guidelines where it is acknowledged that what is categorised as E, S or G is determined by the CRA.
- Respondents also argued that the proposed amendments clearly exceed both the scope of the Request for Advice and the CRAR itself on the basis that CRAs are already required to consider all relevant factors when assigning credit ratings, which also implies considering ESG factors where these impact the credit rating.
- Finally, respondents voiced concerns that the proposed amendments would interfere with the content of CRA's methodologies and this would be inconsistent with Article 23 of the CRAR. In this regard, ESMA was requested to avoid imposing a rigid formulation and to allow each CRA the flexibility to design and develop methodologies best suited to their analytical approach.

27. **ESMA response:** ESMA has taken into account the above arguments and is proposing a wording that does not inadvertently amplify or unduly highlight the relevance of ESG considerations within credit factors. The revised approach of Article 4(2) no longer requires credit rating agencies to identify and categorise all qualitative and quantitative factors as E, S, G or other. Instead, credit rating agencies should use and apply credit rating methodologies that list all quantitative and all qualitative factors in accordance with Article 4(2). This information should then be accompanied by a detailed explanation of the elements set out in Article 4(3)(a)-(d). With respect to the information provided under Article 4(3)(d), this approach requires that the qualitative and quantitative factors listed in Article 4(2) will be accompanied by, amongst other elements, information on whether ESG considerations, including ESG risks when they are applicable, are deemed relevant to their creditworthiness assessments. This information should also include an elaboration on why ESG considerations, including ESG risks, are deemed relevant. Finally there should be an explanation as to how these considerations are integrated into the applicable methodology.
28. In ESMA's view this approach will achieve the same objective of ensuring the better documentation of ESG considerations when these are relevant in the credit assessment process according to the applicable credit rating methodologies. It would also provide explicit clarity in the cases where these considerations are not deemed relevant to determining creditworthiness by a credit rating agency.
29. Finally, ESMA believes that reference to key variables, data sources, key assumptions, modelling and quantitative techniques should also be applicable to qualitative factors where relevant, as per its initial proposal for Article 4(2)(b). To improve clarity ESMA has rephrased its proposal by adding reference to these elements under both Article 4(2)(a) and 4(2)(c).

#### 2.4.1.5 Validation of data used for the development of methodologies (Question 8)

30. Most respondents did not object to ESMA's proposal to improve aspects around the validation of a credit rating methodology. They were supportive of the principle of Article 7(3)(ca) to ensure that the validation of a credit rating methodology is designed to assess the completeness, accuracy and appropriateness of the input data used for its development. However, respondents raised concerns around the scope of what should be validated and how the provision should be understood in practice. Specifically, respondents raised concerns that the amendment suggested that the validation assessment of "completeness, accuracy and appropriateness" under Article 7(3) would also be applicable to the input data used in methodologies. In the views of respondents it would be inappropriate to apply the same validation standards to input data. They believe that CRAs should be able to rely on data that they consider to be from a reliable source. Additional concerns were raised as to what 'completeness' and 'appropriateness' of data is meant in this context. In this regard, some respondents suggested that it would be more appropriate that such a provision around the quality of input data should be included in Article 4 rather than Article 7 of the Delegated Regulation.
31. **ESMA response:** ESMA has revised the phrasing of 7(3)(ca) to remove concerns of redundancy with Article 7(3)(c) and to clarify that the assessment of input data refers to

the data used to develop the methodology, as opposed to data used in the validation of the methodology.

#### 2.4.1.6 On Annex IDI 5a (Question 9)

32. The majority of respondents were supportive of ESMA's proposals to ensure better disclosure of the relevance of ESG considerations in credit ratings. In this regard, respondents supported enhancing transparency by placing the related 2019 Guidelines in the Level 1 provisions. Respondents also requested clarification as to whether the disclosure requirements applied to new issuances of credit ratings as well as changes thereto flagging that the Guidelines had only referred to changes. It was also noted that the Guidelines suggested the inclusion of a link to a document on how ESG factors were considered in a CRA's credit ratings and that it would be beneficial to replicate this in Annex I.

33. **ESMA Response:** ESMA has adjusted its proposals for disclosure in Annex I of the CRA Regulation only in so far as needed to align with the revised proposals for the integration of ESG considerations in Delegated Regulation 447/2012. ESMA can clarify that the intention of the revised provisions is that they are applicable to both new issuance and changes to credit ratings. In addition the proposed phrasing for Annex I now provides a link to the applicable methodology to benefit from the new provisions in the Delegated Regulation 447/2012 and deliver enhanced traceability on whether and how CRAs integrate ESG considerations in their creditworthiness analysis in accordance with their publicly available methodologies.

#### 2.4.1.7 Sufficiently detailed credit rating methodologies (Question 6)

34. There was general support among respondents with regards to ESMA's enhancing of the requirements on the systematic application of methodologies. At the same time, some respondents raised concerns around the interpretation of "sufficiently detailed", and whether this term was clear enough. Other respondents highlighted the need to adopt a more flexible approach in the formulation of the requirement, stressing that the detail of methodologies should support a consistent approach to the determination of credit ratings.

35. **ESMA Response:** ESMA has re-phrased the formulation of this requirement, the proposed new paragraph in Article 5 is now requiring from a CRA to use credit rating methodologies which are sufficiently detailed and designed to 'support' their consistent application to the determination of credit ratings, rather than 'ensure'.

#### 2.4.1.8 Validation under the Review Function (Question 10)

36. The vast majority of respondents supported the clarification specifying that a CRAs' review function should be responsible for the validation of a credit rating methodology since this, as some respondents highlighted, would remove ambiguity over the role of the review function. Another supporting argument in favour of the clarification was that some CRAs are already complying with this approach. On the other hand, some respondents

stressed the need for an element of proportionality and encouraged ESMA to consider issuing guidance with regards to how this might apply to smaller credit rating agencies.

37. One respondent indicated that their view was that such a revision represented a fundamental change to the level 1 provisions of the CRA Regulation.

38. **ESMA Response:** ESMA has made no changes to the original proposal. ESMA considers that the inclusion of this specification in the regulatory framework will provide clarity on the role of the review function. ESMA does not consider this represents a fundamental change to the level 1 provisions of the CRA Regulation on the basis that the regulation itself establishes the requirement that credit rating agency's methodologies be subject to validation including by appropriate historical experience and back-testing. What is not established in the regulation is who should be responsible for this task. ESMA's proposed addition to Annex I Section A paragraph 9 adds this task to the responsibilities of the review function.

#### 2.4.1.9 Transparency relating to the Validation Framework (Question 11)

39. Most respondents did not object to ESMA's proposal to enhance transparency around the validation framework. However, several concerns were raised. Respondents underlined that the term "validating" is not necessarily well-specified. Others noted that more public disclosure would add undue complexity given that CRAs already use their best endeavour in validating methodologies. It was additionally stressed that the proposed amendment could disadvantage smaller agencies that have access to less quantitative data and have a more limited market reach coupled with a shorter track record. Furthermore, it was noted that the information about the validation process should refer to methodologies in general to avoid overly technical and lengthy disclosures for each specific methodology.

40. **ESMA Response:** ESMA has changed the wording of the original proposal towards a more specific disclosure concerning the process of validation. Reference to "the process of validation" has been replaced with "the process of validation of its methodologies".

#### 2.4.1.10 Additional input: AI & other topics (Question 12)

41. The majority of the respondents recognized that increased transparency when it comes to the use of AI by CRAs, could be of benefit to the market, while noting that such a legislative change could be premature at this stage. In this regard, respondents were most supportive of increased levels of disclosure in cases where AI technology is used in the creditworthiness assessment, with a reduced necessity for such disclosures when it was applied merely for efficiency purposes, like document review.

42. Nevertheless a number of respondents recommended waiting until the implementation of the EU AI Act to understand its implications in a horizontal sense before considering additional disclosure requirements for CRAs specifically. Other respondents suggested completing a cost-benefit analysis or thematic review first.

43. **ESMA Response:** No changes have been introduced as a result of this feedback.

## 3 Annexes

### 3.1 Annex I – Legislative mandate



**EUROPEAN COMMISSION**  
DIRECTORATE-GENERAL FOR FINANCIAL STABILITY, FINANCIAL SERVICES AND CAPITAL  
MARKETS UNION

The Director-General

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**Subject: Request for ESMA technical advice on the best way to update Annex I  
of the CRA Regulation and Commission Delegated Regulation (EU) No  
447/2012**

Dear Verena,

In its Action Plan for Sustainable Finance, published on 18 March 2018, the European Commission invited ESMA in the area of credit ratings: (i) to include environmental and sustainability considerations into its Guidelines on Disclosure Requirements ("Guidelines"), and (ii) to assess the current practice within the credit rating market concerning sustainability considerations.

ESMA published the Consultation Paper on Disclosure Requirements applicable to credit ratings in December 2018. It contained a chapter proposing measures to improve transparency regarding the consideration of ESG factors in credit ratings. ESMA issued Guidelines on disclosure requirements in July 2019 including recommendations for how CRAs should present which credit ratings have been impacted by ESG factors. Those guidelines entered into force in April 2020.

In 2021, ESMA carried out an assessment of results of Guidelines and, reviewed how CRAs incorporate ESG factors in their methodologies.

In July 2019, ESMA also provided a Technical Advice to the Commission advising against explicitly mandating the consideration of sustainability characteristics in CRA's credit assessments. ESMA considered that it could be useful to update the CRA Regulation's disclosure provisions, to provide a more consistent level of transparency around how CRAs are considering ESG factors in these assessments and ensure the CRA regulatory framework keeps pace with ESG developments in other areas.

Commission européenne/Europese Commissie, 1049 Bruxelles/Brussel, BELGIQUE/BELGIË – Tel. +32 229911111



Based on the recent ESMA assessments, as well as the results of the targeted consultation, meetings with stakeholders, and the Impact Assessment accompanying the proposal for the regulation of ESG ratings, two main problems have been identified:

- **Varied degree of rigorousness of the incorporation of ESG factors in the assessment of creditworthiness.** Furthermore, there is heterogeneity in the identification and definition of ESG factors across CRA methodologies.
- **Insufficient disclosure in relation to ESG factors that have influenced changes to credit ratings.** ESMA's assessment suggests that although there has been an increase in the overall level of ESG disclosures in CRAs' press releases since the introduction of the Guidelines on Disclosure Requirements applicable to credit ratings in 2019, there is room for further improvement.

Regulation (EC) No 1060/2009 (the CRA Regulation) requires CRAs to incorporate all driving factors relevant for the assessment of creditworthiness. Specific disclosure requirements are provided for in the Annex I to the CRA Regulation.

The CRA Regulation lays down the empowerment for the Commission to update Annex I of the CRA Regulation via a delegated act in view of market developments. More specifically, such a mandate is set out in Article 37 of CRA Regulation. Therefore, in order to further improve transparency, the Commission could amend the Annex I of the CRA Regulation by specifying that CRAs need to disclose the information on ESG factors that have influenced the credit ratings.

In addition, requirements regarding methodologies are specified in Commission Delegated Regulation (EU) No 447/2012. To ensure more rigorous incorporation of ESG factors in the methodologies and to set conditions that methodologies need to meet in the case of the incorporation of ESG factors in creditworthiness assessment, Commission Delegated Regulation (EU) No 447/2012 could be amended in accordance with Article 38a CRA Regulation.

Against this background, ESMA is invited to provide the Commission with a technical advice assessing the best way to update:

- Annex I of the CRA Regulation, and
- Commission Delegated Regulation (EU) No 447/2012,

in order to ensure a better incorporation of ESG factors in the methodologies and rating process and the further disclosure to the public.

We would welcome to receive the above-mentioned advice by end 2024.

Yours faithfully,

[Electronically signed]

John BERRIGAN

## 3.2 Annex II – Cost-benefit analysis

### Cost-benefit analysis

The cost-benefit approach takes into account the related European Commission's impact assessment<sup>6</sup>, ESMA's regulatory and supervisory experience as well as the feedback received from the related consultation which run from April to June 2024. It presents, first, the benefits collectively for all entities and market participants including investors, issuers and users of ratings. It then, differentiates between the main costs, including compliance and supervisory costs, which are discussed accordingly for the CRAs and ESMA.

Options	Qualitative description
<b>Objective</b>	Changes to the Delegated Act on Methodologies and Annex I of the CRA Regulation to a) enhance traceability on the integration of ESG considerations in the credit rating methodologies where they are considered relevant by CRAs in the creditworthiness assessment and better subsequent disclosure to the public, and (b) update a number of provisions of this Delegated Act and Annex I of CRAR to reflect supervisory observations.
<b>Benefits</b>	<p>ESMA's supervisory observations, the related input from the European Commission, as well as continued concerns expressed by stakeholders, have indicated a persisting lack of transparency on how CRAs incorporate sustainability risks in their methodologies, when these considerations have been deemed credit material.</p> <p>ESMA considers that the changes proposed to the Delegated Act and Annex I of the CRA Regulation are necessary to achieve the above listed objectives and address concerns that have been identified as part of ESMA's supervisory observations.</p> <p>The proposed changes will increase transparency around how ESG considerations are taken into account, where relevant, in credit rating methodologies. ESMA considers that this will be of</p>

<sup>6</sup> "Targeted consultation on the functioning of the ESG ratings market in the European Union and on the consideration of ESG factors in credit ratings" ([finance-2022-esg-ratings - European Commission \(europa.eu\)](https://finance-2022-esg-ratings - European Commission (europa.eu))).



	<p>benefit to the financial industry by enabling all market participants in taking more informed financial decisions.</p> <p>In addition, the changes proposed will enhance ESMA's ability to assess compliance of CRAs methodologies with the requirements of the CRA Regulation. These more specific provisions will also improve ESMA's ability to supervise CRAs compliance with the requirements of the CRA Regulation.</p> <p>In addition, ESMA considers that CRAs will benefit from the proposed amendments on the basis that they will gain greater clarity on ESMA's supervisory expectations in this area.</p> <p>The proposed revisions will also simplify supervisory engagement by reducing the need for ad-hoc interventions to highlight the importance of consistent disclosures.</p> <p>ESMA also considers that a greater convergence between CRAs' disclosures will reduce informational asymmetries and contribute to ESMA's core tasks of investor protection within a sustainable EU.</p>
<b>Costs to CRAs</b>	<p>In order to ensure compliance with the proposed revisions, ESMA considers that CRAs will need to revise their internal processes and, possibly, update their existing methodologies. The level and extent of these costs will depend on how far a CRA has already gone with regards to the incorporation of ESG considerations in their credit rating methodologies and disclosures.</p> <p>ESMA expects that these operational and compliance costs will be adjustment short-run costs and will depend on the extent to which CRAs have:</p> <ul style="list-style-type: none"> <li>- already adapted their processes to the specific requirements of ESMA's 2019 Guidelines and more generally, to the widespread demand for heightened awareness on sustainability risks in financial markets, and</li> <li>- complied with ESMA's ongoing monitoring/supervisory actions relating to the implementation of the whole set of provisions of the Delegated Regulation and the CRA Regulation.</li> </ul> <p>In the medium/long term, these costs are expected to be reduced through the gradual implementation of the harmonised EU regulatory package on sustainable finance. CRAs are expected to increasingly benefit from the latter which is expected to provide more standardised informational inputs. These</p>

	<p>comprise, e.g., the taxonomy framework, ESG definitions and labels, targeted sustainability disclosures and regulated information from financial market participants, as well as the ESG ratings per se, and other forthcoming, sectoral or not, EU and international, regulatory developments.</p> <p>Based on the above, CRAs are not expected to face material legal or reputational costs.</p> <p>Overall, only a small additional compliance burden is expected as a direct result of the application of the proposed changes. These costs are expected to diminish in the medium/long-term.</p>
<b>Costs to regulator</b>	<p>ESMA has acquired significant supervisory experience since the introduction of the CRA Regulation. It has also extensively monitored the way CRAs embed the ESG risks into their credit rating analysis. These elements point to a limited incremental supervisory cost for ESMA in this regard.</p> <p>More generally, ESMA's proposals are forward looking, outcome focused and aim to heighten legal certainty. This means that they are expected to proactively enhance the efficiency and effectiveness of CRA's supervision.</p> <p>At the same time, the transition to sustainable finance is central to ESMA's priorities as a result, costs of adapting to the new ESG EU prerequisites are transversal to ESMA's activities.</p> <p>Furthermore, the proposed changes do not entail interference with the design of credit rating methodologies. For example, ESMA does not propose a specific E, S or G categorisation nor expands on the interlinkages between these three components. ESMA is neither mandating the inclusion of ESG considerations into the creditworthiness analysis when not relevant according to the CRA's applicable methodology. It is for CRAs to affirm, where applicable, how they incorporate ESG considerations into their creditworthiness assessments. Overall, ESMA is not expected to face critically heightened supervisory or other costs after the adoption of the proposed changes.</p>
<b>ESG-related aspects</b>	<p>The revision to the RTS and Annex aim to enhance transparency in the integration of ESG considerations in credit rating methodologies, where CRAs consider them to be relevant in their creditworthiness analysis and according to the applicable methodology.</p>

<b>Innovation-related aspects</b>	<p>The consultation paper included a question on the necessity to propose enhanced disclosures on the use of technological innovations, such as Artificial Intelligence (AI), in the rating process. ESMA has taken note of the responses received in this regard.</p>
<b>Proportionality-related aspects</b>	<p>The elements proposed apply uniformly to all credit rating agencies. The ultimate objective is the provision to the financial industry of robust credit ratings which are based on the whole spectrum of critical available information. This, by definition, cannot be mitigated by proportionality considerations.</p>

### 3.3 Annex III

Proposed Delegated Regulation amending Commission Delegated Regulation (EU) No 447/2012

COMMISSION DELEGATED REGULATION (EU) XXX/XXXX

of XXX

amending the regulatory technical standards laid down in Delegated Regulation (EU) No 447/2012 for the assessment of compliance of credit rating methodologies.

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies <sup>(7)</sup>, and in particular point (d) of Article 21(4) thereof,

Whereas:

1. When Environmental, Social and Governance (ESG) considerations are deemed relevant by a credit rating agency in determining creditworthiness, it is necessary that this is documented in the applicable methodology. This will enable an adequate traceability of how ESG considerations, including where applicable ESG risks, have been taken into account by a CRA as well as the subsequent disclosure to the public.
2. In the cases where ESG considerations are nevertheless not deemed relevant by a credit rating agency in determining creditworthiness, credit rating agencies should be required to make an explicit reference to this when providing their detailed explanation on credit rating methodologies. This will ensure that credit rating agencies conduct the necessary assessments on ESG considerations, including ESG risks, and ensure transparency for the users of the credit ratings on that credit rating agency's conclusions.
3. In order to ensure a consistent assessment of compliance of credit rating methodologies with the requirements set out in Article 8(3) of Regulation (EC) No 1060/2009, it is important to be clarified that ESMA, considers that a credit rating methodology is the framework used by a credit rating agency in determining credit ratings and rating outlooks.

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<sup>7</sup> OJ L 302, 17.11.2009, p. 1.as amended.

It may include elements such as criteria, models, driving factors and key rating assumptions relevant to the creditworthiness assessment.

4. Credit rating methodologies should be designed, to enable their systematic application. In this sense, they should embody a sufficiently detailed guidance to persons who apply them. In addition, it is also necessary to clarify that the validation of credit rating methodologies should be designed, inter alia, to adequately assess the input data used for the development of a credit rating methodology.
5. Following the amendments to Regulation (EC) No 1060/2009 introduced by Regulation (EU) No 462/2013 of the European Parliament and of the Council<sup>8</sup> in relation to rating outlooks, it is necessary to clarify that the requirements of Delegated Regulation (EU) No 447/2012 also apply to rating outlooks, where relevant. More precisely the CRAR inter alia calls upon credit rating agencies to adopt, implement, and enforce measures to ensure that the outlooks are based on a thorough analysis of all the information that is available to them and that is relevant to their analysis according to the applicable methodology. Furthermore, CRAs are called to disclose rating outlooks along credit ratings following established and documented procedures and rating methodologies used by the credit rating agency to determine credit ratings and rating outlooks.
6. Delegated Regulation (EU) No 447/2012 should therefore be amended accordingly.
7. This Regulation is based on the draft regulatory technical standards submitted by the European Securities and Markets Authority (ESMA) to the Commission.
8. ESMA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits, consulted the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA) and requested the advice of the Securities and Markets Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council.

HAS ADOPTED THIS REGULATION:

#### *Article 1*

Delegated Regulation (EU) No 447/2012 is amended as follows:

- (1) in Article 3, paragraph 2 is replaced with the following:

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<sup>8</sup> Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies (OJ L 146, 31.5.2013, p. 1).

‘2. When examining the compliance of credit rating agencies with the requirements set out in Article 8(3) of Regulation (EC) No 1060/2009, ESMA shall:

- (a) use all information relevant to assess the process of developing, approving, using, validating and reviewing credit rating methodologies;
- (b) consider that a credit rating methodology is the framework used for the determination of a credit rating, including, where applicable, criteria, models, driving factors and key rating assumptions relevant to the creditworthiness assessment; and,
- (c) consider that the requirements applicable to credit ratings apply also to rating outlooks where relevant and according to the applicable credit rating methodologies.’

(2) Article 4 is amended as follows:

(a) paragraph 2 is replaced with the following:

‘2. A credit rating agency shall use and apply credit rating methodologies which:

- (a) list each qualitative factor, including the scope of qualitative judgement for that factor;
- (b) include the key variables, data sources, key assumptions, modelling, and quantitative techniques applicable to the qualitative factors, where relevant;
- (c) list each quantitative factor; and,
- (d) include the key variables, data sources, key assumptions, modelling, and quantitative techniques applicable to the quantitative factors.’

(b) paragraph 3 is replaced with the following:

‘3. The information referred to in paragraph 2 shall include a detailed explanation of:

- (a) the importance of each qualitative or quantitative factor used within that credit rating methodology, including, where relevant, a description of and justification for related weightings assigned to those factors and their impact on credit ratings;
- (b) the assessment of the relationship between the key assumptions used in that credit rating methodology and the critical risk factors derived from macroeconomic or financial data;
- (c) the assessment of the relationship between the key assumptions used in a credit rating methodology and the volatility of credit ratings produced by that methodology over time; and,
- (d) whether and why ESG considerations, including ESG risks where applicable, are deemed relevant to the credit rating agencies

creditworthiness assessments including how they are integrated into the applicable methodology.’

(3) in Article 5 the following paragraph is added as a third paragraph:

‘3. A credit rating agency shall use credit rating methodologies which are sufficiently detailed and designed to support their consistent application to the determination of credit ratings.’

(4) in the first subparagraph of Article 6 the word ‘shall’ after ‘methodologies’ is deleted.

(5) in paragraph 3 of Article 7, the following new point (ca) is added:

‘(ca) assess the input data used for methodology development for completeness, accuracy and appropriateness;’

#### *Article 2* Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,.

For the Commission

The President

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## **II) Proposed Changes to Annex I of Regulation (EC) No. 1060/2009**

(1) In Annex I, Section D, Rules on the presentation of credit ratings and rating outlooks, I. General obligations, the following paragraph is added as paragraph 5a:

*“5a. When ESG considerations, are a key element underlying a credit rating or a rating outlook, or a change thereto, a credit rating agency shall additionally identify prominently in its press releases or reports these key elements, explaining why they were considered material to the credit rating or rating outlook according to the applicable methodology”.*



(2) In Annex I, Section A, Organisational Requirements, paragraph 9, the words ‘and validating’ are added after the word “*reviewing*” in the first paragraph.

(3) In Annex I, Section D, Rules on the presentation of credit ratings and rating outlooks, I. General obligations, paragraph 2a. the sentence “, *the process of validation of its methodologies*”, is added after the words “it has performed or is relying upon” in paragraph 2a.