Svensk Värdepappersmarknad
Swedish Securities Markets Association

SSMA response to the Commission's targeted consultation on the functioning of the ESG rating market in the EU and on the consideration of ESG factors in credit ratings

27 May 2022

About the Swedish Securities Markets Association

The Swedish Securities Markets Association (SSMA) was founded in 1908 and represents the interests of 24 banks, investment banks and investment firms active in Swedish securities markets.

For further information please visit: www.svenskvardepappersmarknad.se

Consultation response

This SSMA response to part A of the Commission's targeted consultation on the functioning of the ESG rating market in the EU and on the consideration of ESG factors in credit ratings (the "consultation") is based on input from and discussions in the SSMA Sustainability Working Group.

The SSMA in this consultation response notes *inter alia* the following:

- SSMA members use ESG ratings *inter alia* as a starting point for internal analysis, as a source for information for investment decisions, to meet regulatory or reporting requirements, as a reference in financial contracts and collaterals, and for risk management purposes.

- ESG rating providers play an increasingly important role in financial services and markets, and as the ESG rating market grows at global level there is a need for global standards. EU could play a leading role in this work but should consider standards and practices already in existence or in the making in financial markets outside of the EU.

- SSMA does not want to see a streamlining of methods and objectives used by ESG rating providers, but rather prefers a diversity of methods and objectives being used. This said it ESG rating providers should be required to provide information about their methods and objectives, as well as at least high-level information about sources and data used.

- It is important that ESG rating providers manage and are transparent about potential and actual conflicts of interest.

Background information to the consultation is set out in Annex A.

Svensk Värdepappersmarknad
Swedish Securities Markets Association

<u>**Use of ESG ratings and dynamics of the market**</u>

I. Questions for investors, asset managers and benchmark administrators

Do you use ESG ratings?

SSMA members use ESG ratings to a large extent.

Please explain

ESG ratings are increasingly and more generally used in various financial products and services, but also to meet regulatory requirements.

Which type of ESG ratings do you use (non-exhaustive list – multiple answers possible):

SSMA members use a range of ESG ratings providing an opinion on companies including

- ESG ratings providing an opinion on opportunities
- ESG ratings providing an opinion on the compliance of companies with frameworks and rules
- Exposure to and management of ESG risks
- ESG ratings providing an opinion on a company performance towards certain objectives
- ESG ratings providing an opinion on the impact of companies on the society and environment
- ESG ratings providing an opinion on the ESG profile of the company
- ESG characteristics

To what degree do you use ESG ratings in investment or other financing decisions on a scale of from 1 to 10 (1- very little, 10 – decisive)?

SSMA response to this question = 8.

The response to this question depends on how we define the term "ESG ratings" as the meaning of the term is not harmonised. Consequently, it is important to look at the methods, actual findings, and comments on significant risks made by the ESG rating provider.

ESG data is often used as one component in the decision-making process when making investment or other financing decision. ESG ratings, not least the comments and analysis underlying such ratings, are often used as part of the screening process.

Do you use overall ESG ratings or ratings of individual Environmental, Social or Governance factors?

SSMA members use *inter alia* all or some of the below mentioned ratings, as some ESG rating providers focus on climate while others may focus on other aspects of ESG.

- Overall ESG ratings

- Ratings of an individual Environmental, Social and Governance factors
- Ratings of specific elements within the Environmental, Social and Governance factors

Do you buy ESG ratings as a part of a larger package of services?

ESG ratings may be subscribed to as part of a larger package of services. SSMA members buy ESG ratings from several providers and use such ratings as a basis for their own internal processes. It is not common to buy large packages from several providers.

If you responded yes to the previous question, what other services do you buy?

SSMA members buy *inter alia* ESG characteristics datasets as part of these packages.

If you responded yes to the previous question, do you consider that buying ESG ratings as a part of a larger package would give rise to potential conflicts of interests?

There may be conflicts of interests if an ESG rating provider is also involved in and provide other services. As it may not always be possible to avoid conflicts of interests it is important that they are managed in an efficient way and disclosed properly by the ESG rating provider.

Another issue is that the bundling of ESG ratings with other products and services may lead to a situation where clients have to pay for services that they do not need.

What are you using ESG ratings for?

SSMA members use ESG ratings

- as a starting point for internal analysis
- as one of many sources of information that influence the investment decisions
- to meet regulatory or reporting requirements
- as a reference in financial contracts and collaterals
- for risk management purposes
- other(s).

If you use ESG ratings for other purposes, please specify which ones?

ESG ratings can be used as a filtering tool, as part of the client journey, and for scoping purposes.

Do you refer to ESG ratings in any public documents or materials?

SSMA members refer to ESG ratings in public documents and materials.

If you responded yes to the previous question, specify the type of documents of materials

ESG ratings may be used in marketing material and may also be used in the terms and conditions of financial instruments.

What do you value and need most in ESG ratings?

SSMA members value and need the following most in ESG ratings

- transparency in data sourcing and methodologies
- timeliness, accuracy and reliability of ESG ratings
- final score of individual factors

To what degree to you consider the ESG ratings market to be competitive and allows for choice of ESG rating providers at reasonable costs, on a scale from 1 (not competitive) to 10 (very competitive)?

SSMA response to this question = 5.

At present there are several providers of ESG ratings but the number of ESG rating providers are decreasing as smaller good providers are acquired by larger firms. This means that there is a risk that the ESG ratings market will come to be dominated by a limited number of large providers of ESG ratings. This may in turn lead to higher costs for users of ESG ratings. At the same time, there are economies of scale, as ESG rating providers must be able to process large amounts of data and cope with future regulatory requirements.

This being said, it is also possible that over time, as ESG data is standardized and becomes more easily available, firms may buy "raw" ESG data directly from the source and process such information internally. There may also be a market for regional more focused niche ESG rating providers, if and when large ESG rating providers focus om major markets and companies.

Questions for all respondents

Do you consider that the market of ESG ratings will continue to grow?

SSMA is of the view that the ESG ratings market will continue to grow.

If you responded 'yes' to the previous question, to what extent do you expect the following factors to be decisive, on a scale from 1 (not at all) to 10 (very much)?

SSMA considers that the following factors will be decisive, on a scale from 1 (not at all) to 10 (very much).

- Growth in demand from investors in ratings of companies for their investment decisions = 9
- Growth in demand from companies in ratings including on rating future strategies = 9
- Further standardisation of information disclosed by companies and other market participants = 9

Are you considering using more ESG ratings in the future?

Yes, to a large degree.

If you responded 'yes' to the previous question, please explain why

ESG ratings will also increasingly be used in financial products and services. As the ESG ratings market will continue to grow at a global level, there is a need for global standards.

Do you mostly use ESG ratings from bigger or larger market players?

SSMA members mostly use ESG ratings from larger market players.

If you use mostly or exclusively ratings from large ESG rating providers, what are the main reasons for this?

At present there are several providers of ESG ratings but the number of ESG rating providers are decreasing as smaller good providers are acquired by larger firms. At the same time, there are economies of scale, as ESG rating providers must be able to process large amounts of data and also cope with future regulatory requirements.

It could be noted that as a result of the above there is a risk that the ESG ratings market will come to be dominated by a limited number of large providers of ESG ratings. This may in turn lead to higher costs for users of ESG ratings. On the other hand, as ESG data is standardized and becomes more easily available, it may be that firms may buy "raw" ESG data directly from the source and process such information internally. There may also be a market for regional more focused niche ESG rating providers, where large ESG rating providers focus om major markets and companies.

Do you consider there is a sufficient offer of ESG ratings from providers located in the European Union?

No.

If you responded 'no' to the previous question, please explain why

Several smaller ESG rating providers have in recent years been acquired by larger firms, most of them from the United States. While this may not be a problem in and of itself it raises questions when it comes to the regulation and supervision of ESG rating providers active in the EU.

Finally, do you use other types of ESG assessment tools than ESG ratings (e.g. controversy screening, rankings, qualitative assessments, etc.)?

Yes.

If you responded 'yes' to the previous question, how important are these tools in relation to the implementation of your investment strategies and engagement policies?

A controversy screening is often done as a first step of an analysis, following which firms do their own internal analysis.

Do you believe that due diligences carried out by users of ESG research are sufficient to

ensure an acceptable level of quality?

No.

If you replied 'no' to the previous question, would you see merit in refining the current definition of research?

ESG rating providers presently interpret datapoints in different ways, and action is required to handle this situation. The preferred and most efficient solution would be that ESG rating providers carry out the due diligence, rather than individual financial firms.

Do you further believe that ESG research products have reached a sufficient level of maturity and comparability to allow users to fully understand the products they use?

ESG research products have not yet reached a sufficient level of maturity and comparability, there is a large development potential.

II. Functioning of the ESG ratings market

How do you consider that the market of ESG ratings is functioning today?

Not well.

Please explain

ESG rating providers are generally doing a good job in a market where margins may, depending on competition, increase in the future. There is however a lack of data from companies, data required for ESG rating providers to do an even better job.

As this is a global market, and as we must be able to compare companies active in different markets, we need global standards for ESG ratings.

To what degree do you consider that the following shortcomings / problems exist in the ESG ratings market, on a scale of from 1 to 10 (1- very little, 10 – important)?

SSMA considers that the following shortcomings/problems exist in the ESG ratings market, on a scale from 1 (very little) to 10 (important).

- Lack of transparency on the operations of the providers = 8
- Lack of transparency on the methodologies used by the providers = 8
- Lack of clear explanation of what individual ESG ratings measure = 5
- Lack of common definition of ESG ratings = 10
- Variety of terminologies used for the same products = 8
- Lack of comparability between the products offered = 8
- Lack of reliability of the ratings = 8
- Potential conflicts of interests = 8

- Lack of supervision and enforcement over the functioning of this market = 10

What do you think of the quality of the ratings offered on a scale from 1 (very poor) to 10 (very good)?

SSMA response to this question = 6.

Please explain why:

The quality of ratings offered is overall good, but it is uneven. There is also a lack of structure and transparency in this market.

ESG rating providers must be much better at providing information about their methods and objectives. They should also be required to provide information, at a more general level considering their need to protect their business model, about sources and data that they use.

SSMA notes that ESG rating providers are often relatively careful when taking positions, and that ESG rating providers use different kinds of information and data.

Users of ESG ratings need to know what specific ESG rating providers are focusing on, as some may as an example focus on financial risks and how a company is affected by ESG factors, while another provider may focus more on the impact (climate, social etc.) a company may have on society.

ESG rating providers may also in various degrees rely on publicly available data and reports, in which case they may focus more on larger companies, while other providers may focus on other aspects and/or smaller companies, making their own estimates.

It is important that we do not provide a "template" for the methods etc. used by ESG rating providers, but rather we should focus on transparency when it comes to methods etc. used by providers.

Do you consider that there are any significant biases with the methodology used by the providers?

Yes.

If you responded yes to the previous question, please specify the biases

- Biases based on the size of the company rated
- Biases based on the location of the company
- Other biases

If you responded 'other biases' to the previous question, please explain which ones

Larger companies may get better coverage as they normally provide more information and disclosures than smaller companies. Smaller companies also run the risk of being rated based on sectoral or similar data, and not on data relating to the specific small company. In addition, there is a risk that larger and more developed markets get a better coverage.

Do you think the current level of correlation between ratings assessing the same sustainability aspects is adequate?

No.

The current level of correlation is relatively low, but this may not necessarily be negative as different ESG rating providers measure different aspects of company activities. On the contrary, the fact that different providers come to different conclusions may indicate that it is difficult to analyze the company in whole or in part.

There is a risk that too much emphasis is placed on numbers, while more focus should be placed on the analysis underlying the rating. It is also important, as noted elsewhere in this response, that emphasis is on transparency and not on the streamlining of business models or methods used by ESG rating providers.

To what degree do you consider that a low level of correlation between various types of ESG ratings can cause problems for your business and investment decision, as an investor or a rated company, on a scale from 1 (no problem) to 10 (significant problem)?

SSMA response to this question = 7.

The current level of correlation is relatively low, but this may not necessarily be negative as different ESG rating providers measure different aspects of company activities. On the contrary, the fact that different providers come to different conclusions may indicate that it is difficult to analyze the company in whole or in part.

There is a risk of "greenwashing" if ESG rating providers come to different conclusions and ratings based on the same set of data, as *inter alia* investment funds or companies may then use the ESG rating that is "best" for them. This risk increases where an ESG rating provider is also selling other products or services to the company being rated unless such conflicts of interest are managed in a robust and transparent manner. The risk also increases if the recipient of such ratings does not carry out its own analysis and comes to an own conclusion, but rather rely solely on the specific rating provided.

How much do you consider each of the following to be an issue, on a scale from 1 (no issue) to 10 (very significant issue)

SSMA considers the following to be an issue, on a scale from 1 (no issue) to 10 (very significant issue).

- There is a lack of transparency on the methodology and objectives of the respective ratings = 10
- The providers do not communicate and disclose the relevant underlying information = 4
- The providers use very different methodologies = 3
- ESG ratings have different objectives (they assess different sustainability aspects) = 6

- Other issue(s) = 8

If you responded 'other issue' in the previous question, please explain which one(s)

SSMA does not want a streamlining of methods and objectives used by ESG rating providers but would rather see a diversity of methods and objectives used. It is however important that ESG rating providers are transparent and open about the methods that they use and of their objectives.

This said the term *ESG rating* covers a number of different methods and objectives, from ESG rating providers that focus on ESG factors impact on the financial results of companies, while other providers may focus more on the impact companies may have on society or the environment.

This in turn means that *inter alia* an investment fund when referring to "ESG ratings" may in fact have very different investment strategies. While one investor invests in companies that are not in a material way negatively affected by climate change, another investor may invest in companies that actively take actions to reduce its carbon footprint.

Do you consider that a variety of types of ESG ratings (assessing different sustainability aspects) is a positive or negative feature of the market?

Rather positive.

Please explain your response to the previous question:

SSMA does not want a streamlining of methods and objectives used by ESG rating providers but would rather see a diversity of methods and objectives used. It is however important that ESG rating providers are transparent and open about the methods that they use and of their objectives.

This said the term *ESG rating* covers a number of different methods and objectives, from ESG rating providers that focus on ESG factors impact on the financial results of companies, while other providers may focus more on the impact companies may have on society or the environment.

This in turn means that *inter alia* an investment fund when referring to "ESG ratings" may in fact have very different investment strategies. While one investor invests in companies that are not in a material way negatively affected by climate change, another investor may invest in companies that actively take actions to reduce its carbon footprint.

To what degree do you consider this market to be prone to potential conflicts of interests on a scale from 1 (very little) to 10 (very much)?

SSMA response to this question = 9.

If you responded 'yes' to the previous question, where do you see the main risks?

SSMA sees a conflicts of interest risk

- Where providers both assess companies and offer paid advisory services

- Where providers charge companies to see their own reports
- In the absence of separation of sales and analytical teams
- With the ownership system of some providers, where the parent company may exert undue pressure or influence on the research and recommendations that a ratings provider offers
- In the lack of public disclosure of management of potential conflicts of interest
- Other conflict(s) of interest

If you responded 'other(s) conflicts of interest' to the previous question, please specify the additional risks you see

ESG rating providers play an increasingly important role in financial services and markets, and it is very important that providers manage and are transparent about potential and actual conflicts of interest.

Conflicts can arise *inter alia* when rated companies pay for access to ratings or other services such as advisory services. There is a risk that companies that do not want to or can pay for ratings will be treated less favorably or will not be rated at all.

ESG analysts are in a similar position as analysts in other fields, and there is a need for rules on independence, conflicts of interest etc. in this area as for other analysts.

To what degree do you consider that the ESG ratings market as it operates today allows for smaller providers to enter the market on a scale from 1 to 10 (1- hard to enter, 10 – easy to enter)?

SSMA response to this question = 2.

What barriers do you see for smaller providers?

It is difficult for small ESG rating providers to remain competitive in the present market for ESG ratings considering the resources required to collect and process large amounts of data. A major barrier for smaller providers is the cost of data and the massive resources required to process such data.

There may however be room for existing and new providers of ESG ratings in areas and markets where large ESG rating providers are not present or where the smaller provider has some sort of competitive edge *inter alia* in the form of superior knowledge about the local market.

Do you consider that the market currently allows for smaller providers who are already present in this market to remain competitive on a scale from 1 (does not allow) to 10 (fully allows)?

SSMA response to this question = 2.

To what degree do you consider the fees charged for ESG ratings to be proportionate to the services provided, on a scale from 1 (not proportionate) to 10 (very proportionate)?

SSMA response to this question = 5.

ESG rating providers cover different parts of the investment universe and in a competitive market it may be possible for new providers to enter the market. Many banks and firms have internal departments and staff focusing on ESG analysis, and they may be in a better position to negotiate prices but also to process more raw data inhouse.

Do you consider that information on the fees charged by the providers is sufficiently transparent and clear?

No opinion.

III. Questions on the need for EU intervention

In light of the current situation and recent developments of the ESG ratings markets, and the potential issues affecting it, this section aims to gather stakeholder views on the need and type of a possible intervention at EU level.

Taking into account your responses to the previous sections, do you consider that there is a need for an intervention at EU level to remedy the issues identified on the ESG rating market?

Yes.

Please explain why:

ESG ratings are increasingly being used in financial products and services, not only in the EU but also globally. The market for ESG ratings is thus a global one and there is a need for global standards.

As global standards will have to start somewhere there is a need for an initiative at EU level, subject to that any such EU rules must take into account standards and practices already in existence or in the making in financial markets outside of the EU. An initiative at EU level would also lead to a level playing field being developed.

If you responded yes to the previous question, what type of intervention would you consider necessary?

Legislative intervention.

If you responded yes to the previous question, what do you consider should be the prime focus of the intervention?

SSMA considers that the prime focus of intervention should be

- Improving transparency on the operations of the providers
- Improving transparency on the methodology used by the providers
- Improving the reliability and comparability of ratings
- Clarifying what is meant by and captured by ESG ratings, to differentiate from other tools and services

- Clarifying objectives of different types of ESG ratings
- Improving transparency on the fees charged by the providers
- Avoiding potential conflicts of interests
- Providing some supervision on the operations of these providers

For each of the points you selected in the previous question, please explain what solutions and options you would consider appropriate

Improving transparency on the operations of and improving transparency on the methodology used by the providers

ESG rating providers must be much better at providing information about their methods and objectives. They should be able to provide information, at a more general level and taking into account their need to protect their business model, about sources and data that they use.

Improving the reliability and comparability of ratings, clarifying terms and objectives etc.

The SSMA does not want to streamline methods and objectives used by ESG rating providers but would rather see a diversity of methods and objectives used. It is however important that ESG rating providers are transparent and open about the methods that they use and of their objectives.

This said the term *ESG rating* today covers a number of different methods and objectives, from ESG rating providers that focus on ESG factors impact on the financial results of companies, while other providers may focus more on the impact companies may have on society or the environment. Reference is here made to what is referred to as *double materiality.*

This in turn means that *inter alia* an investment fund when referring to "ESG ratings" may in fact have very different investment strategies. While one investor invests in companies that are not in a material way negatively affected by climate change, another investor may invest in companies that actively take actions to reduce its carbon footprint.

It is important that we do not provide a "template" for the methods etc. used by ESG rating providers, but rather we should focus on transparency when it comes to methods etc. used by providers. There is also room for a harmonization around terms and descriptions used by ESG rating providers.

Conflicts of interest

ESG rating providers play an increasingly important role in financial services and markets, and it is very important that providers manage and are transparent about potential and actual conflicts of interest.

Conflicts can arise *inter alia* rated companies pay for access to ratings or other services such as advisory services. There is also a risk that companies that do not want to pay for ratings will be treated less favorably or will not be rated at all.

ESG analysts are in a similar position as equity analysts, and there is a need for harmonized regulation and standards in this area. While ESG analysts and analysis may be used in several different parts of a banks' or investment firms' business, they must have a situation that to the extent possible allows then to make independent decisions on ratings.

To make sure that there is a level playing field and that conflicts of interests are properly managed by ESG rating providers, general rules on the management of conflicts should be introduced at EU level, likely further clarified at level 2 and 3. It is however important that any regulations introduced are proportionate and cost efficient, while not hampering future innovation in this important area.

Fee transparency

SSMA members do not presently consider fee transparency to be a problem in practice, but to avoid that this market develops in the same way as equity markets, where market data costs are being discussed, it would likely be valuable to put basic transparency rules in place already from the outset in this area.

Supervision

Without taking a firm position, the SSMA notes that many ESG rating providers are active on a global and cross-border basis, meaning that a case could be made for EU-level coordination of supervision.

Do you consider that the providers should be subject to an authorisation or registration system in order to offer their services in the EU?

Yes.

Please explain why:

If a regulation is introduced for ESG rating providers, there will be a need for an authorisation or registration system, as a basis for supervision and follow-up on compliance with such regulation.

Do you consider that the providers should be subject to an authorisation or registration system in order to provide ESG ratings on EU companies or non-EU companies' financial instruments listed in the EU even if they offer services to global or non-EU investors?

No opinion.

Do you consider that there should be some minimum disclosure requirements in relation to methodologies used by ESG rating providers?

Yes.

Please explain why

The SSMA does not want a streamlining of methods and objectives used by ESG rating providers but would rather see a diversity of methods and objectives used. It is however important that ESG rating providers are transparent and open about the methods that they use and of their objectives.

Do you consider that the providers should be using standardised templates for disclosing information on their methodology?

Yes.

Please explain:

The SSMA does not want a streamlining of methods and objectives used by ESG rating providers but would rather see a diversity of methods and objectives used. It is however important that ESG rating providers are transparent and open about the methods that they use and of their objectives.

Against this background it would be useful and cost efficient if templates could be developed, in collaboration with the industry, providing a framework for the description of methodology. Such framework must however allow for presentation of different business models and continued innovation in this important area.

Do you consider that the rules should be tailored to the size of the provider and hence have smaller providers subject to a lighter regime?

No opinion.

Should providers located outside of the EU, not providing services to the EU investors but providing ratings of the European companies/financial products be subject to a lighter regime?

No opinion.

Annex A

Background information to the consultation from the consultation paper

ESG ratings are used by a wide variety of investors as part of their sustainable investment strategy to take into account risks and opportunities linked to ESG issues. Consequently, these ratings have an increasingly important impact on the operation of capital markets and on confidence of investors in sustainable financial products.

For the purposes of this consultation the term ESG ratings is based on the definition provided in the International Organization of Securities Commissions' (IOSCO) final report on environmental, social and governance (ESG) ratings and data products providers (21 November 2021).[1]

ESG ratings: refer to the broad spectrum of ratings products that are marketed as providing 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, whether or not these are explicitly labelled as "ESG ratings".

Due to the importance and growth of this market, and potential issues identified as to its functioning, in the action plan on sustainable finance, published in March 2018, the Commission announced a study to be conducted to dig further into the specifics of this market.[2]

The study on sustainability-related ratings, data and research ('the study') was published in January 2021.[3] The study identified a number of issues pertaining to the functioning of the market of ESG ratings providers, in particular on transparency around data sourcing and methodologies, as only few firms disclose the underlying indicators or their actual weights of their assessment. The study also highlighted issues in terms of timeliness, accuracy and reliability of ESG ratings. Another issue identified related to biases, based on the size and location of the companies. Finally, it highlighted potential conflicts of interest associated with certain aspects of their work, including where providers both assess companies and offer paid advisory services or charge companies to see their own reports.

The study further identified a rapid growth in global assets committed to sustainable and responsible investment strategies over the last decade, which is forecast to continue as sustainable investing becomes fully integrated into asset management. This leads to higher demand by investors for ESG ratings to help them decide on particular investment strategies.

The study identified two key trends over the past five years - being consolidation and

[1] FR09/2021 Environmental, Social and Governance (ESG) Ratings and Data Products Providers (iosco.org)
[2] Renewed sustainable finance strategy and implementation of the action plan on financing sustainable growth | European Commission (europa.eu)
[3] Study on sustainability-related ratings, data and research - Publications Office of the EU (europa.eu)

reinforcement of the established ESG ratings providers, and growth in the overall number of providers due to new market entrants.

The study also highlighted that it is challenging for new market entrants to replicate and compete with the larger providers due to high initial level of investment needed to cover a broad range of ESG issues, with as many as a thousand data points, across thousands of companies.

As part of the consultation on the renewed sustainable finance strategy, which took place in early 2021, the Commission asked stakeholders about their views on the quality and relevance of ESG ratings for their investment decisions, on the level of concentration in the market for ESG ratings and need for action at EU level.[4] This confirmed the conclusions of the study, Stakeholders indicated that better comparability and increased reliability of ESG ratings would enhance the efficiency of this fast growing market, thereby facilitating progress towards the objectives of the EU green deal.[5]

This consultation will directly feed into an impact assessment that the Commission will prepare in the year 2022 in order to assess in detail the impacts, costs and options of a possible EU intervention. This consultation should help further clarifying and quantifying the main findings from the study and input received from market participants.

On 3 February 2022, the European Securities and Markets Authority (ESMA) published a call for evidence, complementary to this consultation, in order to support the exercise and provide a mapping of ESG rating providers operating in the EU.[6] The call for evidence also looks at possible costs of supervision would these providers become subject to some supervision.

Subject to the result of this impact assessment, the Commission would propose an initiative to foster the reliability, trust and comparability of ESG ratings by early 2023.

This consultation also seeks views from market participants on the use of other types of tools that can be offered by sustainability-related providers, including research, controversy alerts, rankings, etc.

Functioning of the ESG ratings market

The study identified several issues on the functioning of the ESG ratings market that may hamper its further development.

In particular, there is an overall demand for greater transparency of objectives sought, methodologies adopted and quality assurance processes in place ESG rating providers.

The timeliness, accuracy and reliability of the output from ESG ratings providers were also

[4] Consultation on the renewed sustainable finance strategy | European Commission (europa.eu)
[5] A European Green Deal | European Commission (europa.eu)
[6] ESMA launches Call for Evidence on ESG ratings (europa.eu)

identified as issues for the good functioning of this market.

Another issue identified in the study concerns the existence of biases and low correlation across ESG ratings.

The potential for conflicts of interest, particularly associated with providers both evaluating companies and offering paid advisory services, was further highlighted. The study stressed that providers selling multiple products require an appropriate separation between departments to avoid potential conflicts of interest.

This section aims to inform on the functioning of the ESG ratings market and potential issues that hamper its development and trust by market participants.

*****