

Swedish Securities Markets Association Position on the proposed Regulation on the Transparency and Integrity of ESG Rating Activities

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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 securities markets in Sweden¹.

The position set out herein on the proposed regulation on the transparency and integrity of ESG rating activities (the “Proposal” on the “Regulation”) is based on discussions in the SSMA Sustainability Working Group and follows on SSMA responses SSMA to recent ESG rating consultations of the Commission² and ESMA³.

1. ESG ratings play an important role in financial markets

ESG rating providers (“Providers”) play an increasingly important role in financial services and markets, as the market for ESG ratings will continue to grow due to an increase in demand from investors, companies, and advisors. This growth in demand follows *inter alia* from the requirements being imposed on financial institutions and market participants by sustainable finance legislation such as CSRD, SFDR, and the Taxonomy Regulation, as well as the future increased availability of ESG data in the ESAP.

As an example, SSMA members use ESG ratings in their advisory and other business activities *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.

1.1 Concentration risks in the market for ESG ratings

SSMA notes the information in the Proposal that at present some 59 entities are active in the ESG ratings market, of which 30 are based in the EU and 29 are based outside of the EU. However, SSMA also notes that some smaller Providers have in the past been acquired by larger Providers, leading to a risk that the EU market will in future come to be dominated by a few large Providers. This may in turn, if proper rules are not agreed and implemented, lead *inter alia* to increased costs for users of ESG ratings.

¹ For further information please visit: www.svpm.se

² [SSMA response to COM targeted consultation on ESG ratings – Svensk Värdepappersmarknad \(svenskvardepappersmarknad.se\)](#)

³ [SSMA response to ESMA call for evidence on market characteristics for ESG Rating Providers in the EU – Svensk Värdepappersmarknad \(svenskvardepappersmarknad.se\)](#)

This said, SSMA recognizes that there are economies of scale in this market, as Providers must be able to process large amounts of data and cope with (future) regulatory requirements. SSMA hereby note the importance of Providers having adequate resources *inter alia* to interact with users of ESG ratings as well as the companies being rated.

1.2 Importance of Providers being close to markets where they are active

It could here be noted that SSMA members have historically found themselves in situations where it has been very difficult to establish contact with analysts working for Providers *inter alia* when they have found information published by Providers to be factually incorrect. This problem may then be made worse if an analyst in question is not properly acquainted with the way societies in the EU or in a particular EU country works.

As an example, benefits and rights that are in some countries provided by companies, such as health or disability benefits or a “right” of employees to strike or join a labor union, are in Sweden provided by the state and set out in laws, forming a natural part of society. It is therefore very important that Swedish companies are not punished by Providers for not providing such benefits or rights.

2. Regulation and supervision of Providers

SSMA has in previous consultation responses noted the lack of supervision and enforcement in the market for ESG ratings. The SSMA thus agrees with the Commission that this market does not function properly, agrees with the objectives of the Commission, welcomes the Proposal, and express the hope for a swift and balanced legislative process and coming agreement between the Council and European Parliament on the Regulation.

2.1 Importance of aligning the Regulation with other relevant rules

SSMA notes and agrees with the Commission’s references in the Proposal to links that exist between the Regulation and other legislation such as the CSRD, SFDR, the Taxonomy Regulation, the EU Green Bond Standards, and the EU Climate Benchmark Regulation.

SSMA would against this background like to underline that it is important that these and any other relevant rules are aligned, to avoid to the extent possible overlapping and contradicting rules in the field of Sustainable Finance.

2.2 Rules aimed at small and medium-sized Providers

SSMA believes that it may be difficult for small Providers to remain competitive in the 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.

This said, SSMA considers that there may be room for existing and new *niche* Providers in markets and areas where larger Providers are not active or where the smaller Provider has a competitive edge *inter alia* in the form of better knowledge about the local market.

While SSMA supports the introduction of some mitigation measures for SME Providers, we also note the importance of such measures not leading to situations where the integrity of and confidence in the ESG ratings market being undermined *inter alia* by less serious or under-resourced SME Providers. It is thus important that any mitigation measures or exemptions granted are based on a thorough analysis by ESMA, considering potential benefits as well as potential risks.

2.3 Importance of creating a level playing field based on global standards

The market for ESG ratings is global in nature and the aim should be to get to a situation where we are able to compare companies active in different markets. When developing our rules in the EU it is thus important that we consider standards already in existence or in the making in financial markets outside of the EU. Made in the right way we do however see that this EU initiative could contribute to achieving global standards and a global level playing field in the market for ESG ratings.

SSMA notes that several smaller ESG rating providers have in recent years been acquired by larger firms, most of them from the United States. While the SSMA does not see this as a problem it raises questions as to the regulation and supervision of Providers from countries outside of the EU.

As it is important to have a level playing field in all respects between Providers that are coming from countries in- and outside of the EU, SSMA supports the proposal that ESMA should be given the task of supervising ESG ratings offered in the EU, by all Providers, regardless of where they come from. It is also important that ESMA is given all powers necessary to supervise, conduct investigations etc. in relation to such Providers.

It is in this context important that ESMA carefully considers the content and effects of regulatory frameworks of non-EU jurisdictions when taking equivalence decisions, so that the integrity of the market for ESG ratings in the EU is not in any way undermined by non-EU Providers.

3. ESG rating definitions, exemptions, and risk of greenwashing

SSMA welcomes the introduction in the Regulation of a definition of the term “ESG rating” as this is a missing piece in the ESG legislative framework. Presently, a variety of terminologies exist and may be used for similar or the same products, sometimes leading to confusion and a lack of comparability between products.

Providers as well as the term *ESG rating* presently cover a wide variety of methods and objectives, from Providers focusing on the impact of ESG factors on the financial results of companies, to Providers focusing on the impact companies may have on society or the environment. Similarly, investors that make a reference to an *ESG rating* may have very different investment strategies. While one investor may invest in companies that are not materially and negatively affected by climate change, another may invest in companies that actively take actions to reduce its carbon footprint.

SSMA in this context notes that the current level of correlation between ratings assessing the same sustainability aspects is relatively low. Such lack of correlation may not necessarily be a bad thing, as different Providers may measure different aspects of a company’s activities. Differences in ratings

may also indicate that it is difficult to analyze a company.

At the same time, the above highlights the importance of transparency on the side of Providers about methods used and of the objectives of the rating. While SSMA does not support the streamlining of business models or methodologies used by Providers, there is room for harmonization of terms and descriptions used by Providers.

3.1 Rules relating to changes of ESG ratings

As ESG ratings, as well as changes in such ratings, may have material consequences for market participants and rated companies, it is important that robust rules apply to the information about changes of ESG ratings and the process leading up to such changes.

SSMA would in this context specifically emphasize that it is not sufficient if a rated company that is subjected to a change in ESG rating that it considers to be incorrect is referred only to a complaints-handling mechanism as set out in Article 18 of the Regulation.

3.2 Exemptions for in-house and other private ESG ratings as well as for products or services that incorporate an element of an ESG rating

SSMA notes and supports the exemption set out in Article 2.2 (b) of the Regulation for in-house and other ratings developed by financial institutions and other market participants for own purposes or their own use, as well as the exemption set out in Article 2.2 (e) for products and services that incorporate an element of an ESG rating, noting the importance of making sure that the Regulation in its adopted version covers relevant practices already in existence.

In connection herewith SSMA notes that within the field of especially equity research ESG has over time become an increasingly important factor and it is now often included as an element in research products. Depending on the final definition of “ESG Ratings” the SSMA is concerned about the risk that the ESG element of research could, if presented separately, come to fall under such definition. As ESG comments/ratings in a research product constitutes a part of a wider product/service, and is not an independent ESG rating product, SSMA supports that investment research products and services are exempted from the ESG rating rules in accordance with Article 2.2 (e).

It could in this context be noted that SSMA members that provide such products or services already fall under the scope of authorization and they are as a consequence already subject to rules on e.g. conflicts of interest and integrity.

It could also be considered if a distinction should generally be made between Providers that are not regulated and financial institutions that are already regulated and have organizations and practices in place to *inter alia* manage conflicts of interest.

3.3 Rules applicable to unsolicited ESG ratings

SSMA notes that the definition of *rated company* also covers companies that have not requested, and may not have provided information for, an ESG rating or score. It is in such circumstances of importance that such companies are made aware of the situation, and that it is in such cases are made clear who is paying for the rating or score.

With reference to what is set out below about conflicts of interest, it is in the above situation of utmost importance that a company that is not paying for an ESG rating or score is not placed at a disadvantage vis-à-vis a company that is willing to pay for such rating or score.

3.4 Risk of greenwashing in the ESG ratings market

SSMA notes that in the absence of robust rules on *inter alia* the methodologies of and information to be provided by Providers, a greenwashing risk exist, as Providers may give different ESG ratings based on the same set of data.

As an example, an investor or company that is provided with different ESG rating may decide to use the one that suits it best. This greenwashing risk increases if a Provider is also selling other products or services to the investor or company in question, highlighting the need for transparency as well as robust rules on conflicts of interest.

SSMA would in connection herewith point to the risk that some users of ESG ratings may come to place too much emphasis on numbers, where more focus should be placed on the analysis underlying the rating.

4. Methods and objectives used by Providers

SSMA does as a starting point not want to see a streamlining of methods and objectives used by Providers, but rather prefers a diversity of methods and objectives being used. The SSMA thus welcomes the clarification in the Proposal that the intention behind the Regulation is not to harmonize the methodologies for the calculation of ESG ratings, but to increase their transparency *inter alia* on the methodologies, models, and key rating assumptions.

Users and subjects of ESG ratings need to know what specific Providers are focusing on, as one Provides may as an example focus on financial risks and how a company is affected by ESG factors, while another Provider may focus on the climate, social and other impacts a company has on society.

4.1 Information that does not have to be disclosed by Providers

SSME notes that there may be sensitive information *inter alia* about methodologies used that a Provider may not want to disclose. This said, it is important that users of ESG ratings and companies that are rated, on a solicited or unsolicited basis, are placed in a position where they can test, verify and if needed challenge the Provider. If this is not possible there is a risk that the work and methods of Providers continue to be a *black box* for users and companies that are rated.

Against this background, SSMA would consider that the proposed Art 14.12 of the Regulation, providing that Providers shall not have to disclose information about their intellectual capital, intellectual property, know-how or the results of innovation that would qualify as trade secrets as defined in Article 2, point (1), of Directive (EU) 2016/943 of the European Parliament and of the Council, is too far-reaching.

SSMA would in addition emphasize the importance of ESMA under all circumstances having a right to access and test any information that may not be publicly disclosed with reference to the above rule.

4.2 ESG ratings of large companies vs. SMEs

SSMA notes that there is a risk of bias based on the size of the company being rated. This situation may be difficult to change, as Providers often rely on publicly available data and reports that are easier to obtain for larger companies than for SMEs. Another risk facing SMEs is that they run the risk of being rated based on sectoral or similar data, and not on data relating to the specific SME.

While the introduction of new rules such as CSRD and the building of the ESAP may over time have positive effects in this regard, it is important that Providers put processes in place to ascertain that SMEs are informed about any ratings about to be placed on them, so that they can verify or correct information about them.

SSMA would in this context like to note that a situation like the one referred to above exists when it comes to large/developed vs. small and medium sized/less developed capital markets – reference is here made to the above discussion in Part 1.1 and 1.2.

4.3 Development of templates in collaboration with market participants

While the SSMA is in favor of Providers right and ability to develop their own business models and methodologies, it also notes that it would be useful and cost efficient if templates could be developed, in collaboration with relevant market participants, providing a framework for the terminology and information provided around different methodologies, allowing for continued innovation.

5. Management of conflicts of interest

As Providers play an increasingly important role in financial services and markets it is important that they are made subject to robust conflicts of interest rules, in line with what is set out in the Proposal.

SSMA would in this context specifically like to point to the risk that companies that do not want to or can pay for ESG ratings may be treated less favorably or will not be rated at all by Providers.

SSMA also notes that employees of Providers are in a similar position as equity analysts and support the introduction of harmonized and robust standards on the independence and management of conflicts of interest in this area. Analysts and other employees of Providers must have a work situation that makes it possible for, in practice as well as in theory, them to make independent decisions relating to the content of and process relating to ESG ratings.

6. Costs issues and bundling

ESG ratings may be subscribed to separately or as part of a larger package of services, and while SSMA members do not presently consider fee levels or transparency to be a major problem, it is important that we avoid a situation where the ESG ratings market goes in the same way as in equity markets, where market data costs have become a real issue.

Against this background, SSMA supports the Commission's proposed Art. 25.1 which provides that fees charged to clients should be fair, reasonable, transparent, non-discriminatory, and based on actual cost, as well as Art. 25.2 giving ESMA powers to intervene against non-compliant Providers. This said, it is also important that lessons be learnt from the situation in equity markets, so that clear and robust rules on costs and fees are put in place already from the outset.

In this context, SSMA would like to point to the risk that ESG ratings are bundled with other products and services that may not be required or requested by users or clients. It is thus important that ESMA monitor the business activities of Providers, so that they do not use their position to *inter alia* require clients or others to buy bundles or services, if and where such bundles or services are not requested by users or buyers.
