



Feedback statement on the Proposal for a Regulation of the European Parliament and of the Council on the Transparency and Integrity of Environmental, Social and Governance (ESG) rating activities (COM(2023) 314 final)

24 August 2023

Eumedion, representing the interests of institutional investors with a long-term investment horizon and – collectively – with a more than € 8 trillion global investment portfolio, welcomes the European Commission’s efforts to increase the transparency and integrity of the ESG ratings market. The ESG data and ratings market has become significantly more important over the last few years, with growing demand from users for more and high-quality data and company performance evaluations. If anything, this growth in demand is only expected to increase in the coming years. Simultaneously and as underlined by the many EU initiatives in this area, the societal urgency to address the ESG issues in scope has never been greater, stressing the importance of reliable sustainability data and ratings. Overall, the ESG data and ratings market, in light of the various issues already identified in the 2020 European Commission’s report, cannot yet meet the high standards required by the importance and the urgency of the ESG issues and for the financial markets to deploy their full capability in contributing to a more sustainable future.

As pointed out in our June 2022 consultation response,¹ Eumedion would have preferred a targeted EU intervention based on a self-regulation approach rather than on a regulation. In our view, a legally binding self-regulation approach would have been better suited to continue to enable the continuous need for innovation in the ESG rating industry. Still, many important elements that Eumedion pointed out in its earlier response have been included in the current proposal for a regulation, such as specifications of transparency requirements, management of conflicts of interests and other safeguards, a registration and authorisation process, supervision by ESMA, and an evaluation of the effectiveness of the regulatory approach. In this feedback statement, we would like to point out some concerns regarding the effectiveness and the feasibility of some elements of the proposal, as well as some suggestions for further improvements. In the Annex to this statement we have included some further technical remarks.

¹ The Eumedion response of June 2022 can be consulted here: <https://www.eumedion.nl/clientdata/215/media/clientimages/Response-EC-consultation-ESG-ratings.pdf?v=230619115747>.

1. Consider promoting alignment with relevant initiatives within the broader EU sustainable finance framework

Where applicable and necessary, we feel it would be desirable to explore options to further promote alignment of ESG ratings with other EU policy initiatives in the area of sustainable finance (including CSRD, future CSDDD, SFDR and Taxonomy), which is at least partially covered by various (minimum and additional) disclosures requirements laid down in Annex III to the proposal. Clarity on how ratings or methodologies are qualitatively connected to relevant initiatives could for example be covered by guidance to be developed by ESMA. Promoting (transparency on) alignment could also contribute to decreasing the burden for companies to respond to information requests, if easy (cross-legislative) comparisons are possible between metrics and necessary source data. This would be in line with recital 14, which states that the Regulation is to complement the existing EU sustainable finance framework.

2. Scope of application should not (unintentionally) capture asset managers

Eumedion would like to point out that the scope of the proposed Regulation should be sufficiently granularly defined to not (unintentionally) capture asset managers, especially where it concerns disclosing information for regulatory purposes or with a link to intra-group contracts.

Specifically, we suggest to amend recital 15 and article 2(2) of the proposed Regulation to reflect that the rules should *not* apply to ESG ratings produced by European financial undertakings that:

- *Are used, inter alia, for internal purposes or shared within a group;*
- *Are used, provided or disclosed as an ancillary element to a product or service;*
- *Are developed and disclosed within the scope of existing EU regulations, such as Regulation (EU) 2019/2088 (SFDR) and Directive 2014/65/UE (MIFID 2);*
- *Are investment research products, such as equity research reports, which may incorporate ESG considerations but which are different to the ratings of only ESG matters;*
- *Are disclosed open source or free of charge.*

3. Potential exemptions to requirements for small or medium-sized undertakings should not compromise on the general principles targeting the quality and integrity of ratings

An EU intervention based on a regulation carries the risk of burdening emerging innovative companies in the industry with a disproportionate regulatory framework that would hamper competition and innovation. This is not in the interest of investors. Additionally, this could unintentionally contribute to the domination of the industry by a handful of players. Therefore, certain provisions are needed to limit the negative effects on innovation and competition, while at the same time safeguarding quality and integrity of the ESG ratings market. The proposal (under article 20) allows certain rating providers to apply for exemptions to some of the requirements laid down in article 14. However, such exemptions should not be allowed to compromise on e.g. the rigour of rating methodologies or the prevention of conflicts of interest. We advise that the Regulation makes sufficiently clear that exemptions cannot be granted based on the general principles in article 14 that target qualitative aspects of ESG ratings and their methodologies (e.g. article 14(7)) or that target independence and accuracy (e.g. article 14(5)). In this

light, we would also like to point out that article 20, paragraph 1, inconsistently seems to refer to these 'general principles' of article 14 as 'requirements'.

4. Further clarity on qualitative characteristics of rating methodologies is desirable but should not hinder innovation

In order for ESMA to establish whether ratings and their methodologies adhere to the general and foundational principles, such as being 'based on a thorough analysis of all relevant information available to [the rating providers]' (article 14(4)) and being 'rigorous, systematic, objective and capable of validation' (article 14(7)), further clarity on what constitutes these qualitative characteristics seems desirable. This could be addressed by regulatory standards to be developed by ESMA. However, rapid developments in the area of (corporate) sustainability information, assessments and dimensions of materiality, and/or (regulatory) developments around key topics such as climate change, biodiversity and human rights make this a challenging exercise. This creates a risk of regulation lagging behind or even discouraging relevant innovations in the sector. It is therefore important that further enhancements in this area leave sufficient room for innovation.

5. Strengthen the requirements for engagement with rated entities

Eumedion welcomes the provision that makes sure rated entities receive more detailed information on ESG ratings (article 22 and Annex III(2)). However, we are of the opinion that further engagement requirements with rated entities should be introduced. As per the advice of the November 2022 IOSCO call for action on good sustainable finance practices,² we suggest to include in the proposal a clause that requires rating providers to publish the terms of engagement describing how and when they will typically engage with rated entities, including when information is likely to be requested and the opportunities available to the covered entity for review. Such a clause should also allow rated entities to draw attention to any factual errors in the product, while maintaining the objectivity of the products.³ We would additionally like to point out that the reference to Annex III(2) contains an inconsistency as compared to the text of the proposed Regulation. Article 22 targets the provision of information to 'subscribers', while the Annex refers to 'users' of ESG ratings, which appears to be defined as *all* regulated financial undertakings, but which has a different definition in the Regulation itself.

6. The 'separation of business and activities' by ESG rating providers needs further clarification

The proposal includes the provision that ESG rating providers should not be allowed to offer a number of other activities such as consulting activities and developing benchmarks (recital 22 and article 15). While we support measures to avoid and manage conflicts of interests, it is unclear whether said provision would allow ESG data providers to set up internal barriers between business activities, as is customary in other lines of business and which could be an appropriate measure to address potential

² See <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD717.pdf>.

³ IOSCO Call for action, GP7. The recently published IRSG and ICMA draft code of conduct has included this under principle 6, see <https://www.irsg.co.uk/assets/Papers/DRWG-ESG-Code-of-Conduct-Draft-July-2023.pdf>.

conflicts of interests. If a full legal separation of entities would be required, then not only would this seem a disproportionate measure to appropriately address potential conflicts of interest, but this would probably lead to further concentration in the market for ESG ratings.⁴

7. Consider a transparency requirement for ESG data providers

Eumedion supports excluding from the scope of the proposed Regulation the provision of raw ESG data that do not contain an element of rating or scoring, and that are not subject to any modelling or analysis resulting in the development of an ESG rating (recital 16 and article 2, paragraph 2(c)). We consider this a prudent course of action in light of the various on-going regulatory developments in the area of ESG data and audit (such as the CSRD and the European Sustainability Reporting Standards, EU Taxonomy, ESAP) and other developments potentially affecting this market (such as AI). However, Eumedion would support minimum transparency requirements for said ESG data providers, similar to the requirements laid down for ESG rating providers under Title III, Chapter 2 of the proposed Regulation and focusing on transparency around data sourcing and/or methodologies for estimates. Such a targeted intervention could be based on a self-regulatory approach, such as a code of conduct.

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⁴ The November 2022 IOSCO Call for action calls for appropriate policies to address potential conflicts of interest (GP2). The IRSG and ICMA draft code of conduct additionally states that also potential conflicts of interest arising from a rating providers' organisational structure, business or financial activities should be addressed by such policies (principle 3).

Annex: further technical remarks on the proposal for a regulation

1. Further clarity is necessary on the application of the Regulation to subset(s) of 'ESG' as the objective of ratings

The definition of 'ESG rating' for the purpose of the Regulation (article 3(1)) makes it insufficiently clear that such a rating also qualifies as an 'ESG' rating if it targets E, S or G factors individually, and not necessarily only in combination. We refer also to Annex III, paragraph 1, of the Regulation, where, as we understand it, it becomes clear that also sub-set(s) of ESG as the objective of ratings should be targeted by the Regulation. We suggest to revise the definition to make clear that it concerns ratings with environmental, social *and/or* governance characteristics.

2. If a rating is used by a third party, it should be made clear whence the rating originates and where the relevant information can be found

Following article 2, paragraph 2(h), the Regulation does not apply to ESG ratings from an authorised ESG rating provider that are made available to users by a third party. If a third party makes these ratings available, it should be transparent for the end-user whence the rating originates and where the relevant information on the original rating can be found.

3. Specify consequences in case the timeline for processing applications is not met

Article 6 specifies the timelines for ESMA to process applications. However, it is unclear what happens in case ESMA does not meet the specified timelines.

4. Include a public notification clause in case of withdrawal or suspension of authorisation

If per article 8(2) ESMA decides to withdraw or suspend an authorisation with immediate effect, it is in the interest of users of ratings and of the general public that this decision should accordingly be made public. We would be in favour of including a public notification clause under article 8.

5. Take into account the impact of infringements on the interests of all investors

Per article 33(3), ESMA should take into account the nature and seriousness of infringements when taking supervisory measures. This includes the impact of the infringement on retail investors' interests (article 33(3), sub f), but does not explicitly include the impact of the infringement on institutional investors' interests. We would favour extension of this clause to take into account the interests of all investors.

6. The reference to paragraph 6 in article 14 paragraph 8 seems to be incorrect

It appears that a reference should be made to paragraph 7 instead.