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

Financial markets
Corporate reporting, audit and credit rating agencies

CONSULTATION DOCUMENT

TARGETED CONSULTATION ON THE FUNCTIONING OF THE ESG RATINGS MARKET IN THE EUROPEAN UNION AND ON THE CONSIDERATION OF ESG FACTORS IN CREDIT RATINGS

Disclaimer

This document is a working document of the Commission services for consultation and does not prejudge the final decision that the Commission may take.

The views reflected on this consultation paper provide an indication on the approach the Commission services may take but do not constitute a final policy position or a formal proposal by the European Commission.

The responses to this consultation paper will provide important guidance to the Commission when preparing, if considered appropriate, a formal Commission proposal.

You are invited to reply **by 6 June 2022** at the latest to the **online questionnaire** available on the following webpage: https://ec.europa.eu/info/publications/finance-consultations-2022-esg-ratings_en

Please note that in order to ensure a fair and transparent consultation process **only responses received through the online questionnaire will be taken into account and included in the report summarising the responses**.

This consultation follows the normal rules of the European Commission for public consultations. Responses will be published in accordance with the privacy options respondents will have opted for in the online questionnaire.

Responses authorised for publication will be published on the following webpage: https://ec.europa.eu/info/publications/finance-consultations-2022-esg-ratings_en

Any question on this consultation or issue encountered with the online questionnaire can be raised via email at fisma-esg-ratings@ec.europa.eu.

INTRODUCTION

The first part of the consultation aims to inform the Commission on the dynamicsrelating to the ESG ratings market, and on the interplay between larger and smaller market players. This section aims to inform on the use and objectives of ESG ratings.

The second part of the consultation aims to identify possible shortcomings in relation to the consideration of sustainability risks in credit ratings and the disclosures made by CRAs.

CONSULTATION QUESTIONS

PART A – ESG RATINGS

Background information

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).

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 ratingcategories, 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.

The study on sustainability-related ratings, data and research ('the study') was published in January 2021. 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.

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. 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.

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. The call forevidence also looks at possible costs of supervision would these providers becomesubject to some supervision.

Subject to the result of this impact assessment, the Commission would propose aninitiative 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.

I. Use of ESG ratings and dynamics of the market

The study 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 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.

1. Questions for investors, asset managers and benchmark administrators

Do you use ESG ratings?

- Yes, very much
- Yes, a little
- No

Please explain

Comment box The level of relevance of ESG ratings is high, as ESG ratings are already widely used by market actors, as from a methodological point of view, they stand as the best tool to deal with ESG investment and financing decisions.
Banks use ESG ratings with different scope. From an issuer point of view, sustainability factors are dynamic features changing over time and requiring a numerical and granular valuation approach to intercept the sensitivity of an issuer (e.g. its ESG profile, reputation, standing) and the related financial instruments issued.(e.g. their attractiveness). As investment firms, banks assess the level of sustainability of all financial instruments through the “ESG ratings/scoring” in order to identify the

financial instruments capable of satisfying the MiFID sustainability preferences expressed by the clients. Moreover, the adoption of "ESG rating / scoring" allows investment firms to graduate the level of the sustainability characteristics of each financial instruments. It also allows to manage sustainability issues with a portfolio approach, to calculate and monitor the sustainability level of the portfolio as a whole or with respect to the sustainable portion, in line with the expected level and / or the "sustainability-related ambition" indicated by the client in the profiling questionnaire.
The "ESG scorings / ratings" provided by the main info-providers are currently a tool available for investment firms to map, the degree of sustainability-related ambitions / expectation of the financial products falling within the SFDR /Taxonomy scope, and the other financial instruments falling within the scope of MiFID II. The "ESG ratings / scorings" represent a valid "proxy" to identify the financial instruments capable of satisfying the sustainability preferences expressed by the client in the profiling questionnaire.

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

ESG ratings providing an opinion on companies:

- 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 ratings providing an opinion on investment funds or other financial products(please specify which financial products):
- Investment funds

Others
(comment box)

- exposure to and management of ESG risks
- impact on the society and environment
- ESG characteristics

If you responded that you use specialised ratings, please indicate which one(s):

- Comment box

To what degree do you use ESG ratings in investment or other financing decisions on the a scale of from 1 to 10 (1- very little, 10 – decisive)? 5

- Comment box

If you don't use ESG ratings, or use on them to a very small degree, what do you use on in your investment or other financing decisions?

- Comment box

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

Governance factors?

- Overall ESG ratings
- Ratings of an individual Environmental, Social and Governance factors
- Ratings of specific elements within the Environmental, Social and Governance factors,
- other types, please specify

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

- Yes
- No
- Not applicable

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

Comment box: Banks buy other services as economic scenarios supplied by the information provider and used in the process of calculating prices for financial instruments listed on active markets (Mark to Market); rating models provided by external providers are also used to calculate the creditworthiness of the component of exposures arising from the operations. Banks also use ESG ratings from different sources (credit rating agencies as ESG rating agencies, and ESG third-party info provider) to support the origination process and to periodically assess the ESG risk profile of counterparties and issuers of bank portfolios' financial instruments. Other services that are bought are controversy screenings, controversial weapons screenings, country ESG risk, carbin data, SDG data, PAI data, EU Taxonomy, product involvement screening.

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?

- Comment box

What are you using ESG ratings for? (multiple choice)

- 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 decisive input into an investment decision
- 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?

- Comment box: For reporting purposes that are not based on regulatory reporting requirements.

As a benchmark administrator, how do you take into account ESG ratings for the construction of a benchmark and/or in disclosures around a benchmark?

- Comment box

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

- Yes
- No

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

Comment box In general Banks report ESG rating in offering/underwriting documentation (e.g prospectuses/offering circular, subscription agreement), ESG quarterly update to Fixed Income investors, Integrated Report, Corporate WebSite or describe of the use of ESG ratings in own Sustainability Report or Non Financial Statement.

What do you value and need most in ESG ratings:

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

- aggregated score of all factors
- rating report explaining the final score or aggregated score
- specific information, please explain
- data accompanying rating
- other aspects

If you responded 'other aspects' to the previous question, please explain why :

- Comment box

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)?

- Comment box 6

2. Questions for companies subject to ratings

Do you have access to ESG ratings of your own company?

- Yes
- No
- Comment box

To what degree do you use ESG ratings to assess the way you manage sustainability risks and opportunities and your impact on the outside world, on a scale from 1 (not determinant) to 10 (determinant)? 3

Comment box:

ESG ratings do not change per se the way financial institutions manage sustainability risks and opportunities but are used to monitor sustainability risks and opportunities and are considered in the definition of CSR strategies. Thus, they will have an effect on the way their formalize some of their policies. Financial institutions are sensitive to the notation that they get from ESG rating providers. To get a (good) rating, financial institutions must answer the questionnaires send by ratings providers and understand their expectations. These expectations can vary over time and the focus can change (even if there can be differences and divergence among ESG rating providers). To be able to answer they need to produce concrete data, and they can do so by formalizing or identifying all the policies implemented in the group.The influence of ESG rating is therefore limited. They encourage financial institutions to increase transparency on policies they undertake and they or, more precisely, the questionnaires of the agencies help improving banks' internal organization.

If you do not use ratings, what do you use to assess the way you manage sustainability risks and opportunities and your impact on the outside world?

Comment box:

Financial institutions can use ratings while relying on other tools to manage sustainability risks and opportunities. For example, financial institutions set up KPIs pursuant to reporting obligations.However, regulatory KPI are not always aligned with those requested by ESG rating providers. The Corporate Sustainability Reporting Directive (that will soon replace the Non Financial Reporting Directive) will ask undertakings to disclose information on the way they identify, manage and mitigate their sustainability risks.
The disclosures specified in the implementing acts adopted pursuant to Article 434a of Regulation (EU) No 575/2013ITS, soon to be adopted by the Commission, will also require financial institutions to publish their exposures to certain sectors. Finally, undertakings that report under the TCFD must also disclose some KPIs about their risk management, their metrics and their governance.

Does this vary between individual E, S and G factors?

Comment box:

There are differences between financial institutions as their global strategies can vary. Some of them will focus more on “S” or “G” because of their policies.

Nevertheless, some trends can be identified:

- Financial institutions are sensible to the evaluation of their ratings, including the “social” and “governance” aspect
- As the “E” (environment) is more strategic with a regulatory framework more developed, financial institutions have already developed KPIs to assess their impact, therefore the “S” and “G” are more used (as guidance and help formalize policies, for example).

Do you provide information on ESG ratings you have received in any of your public documents?

- Yes
- No
- No opinion

If you responded yes to the previous question, please specify where you disclose this information:

- Answer: Some of these ESG ratings are published, for example in banks’ Universal Registration Document, in the integrated report, on the internet website. Some of these ESG ratings are also disclosed in the prospectus of financial products. Finally, websites are also used to disclose information on ESG ratings.

3. Questions for all respondents

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

- Yes
- No
- No opinion

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)?

- 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 5/6
- Further standardisation of information disclosed by companies and other market participants 9
- Other 9

If you responded 'other' to the previous question, please specify the other reasons you see for this market to continue to grow

Comment box: There is general feeling that the market of ESG ratings will continue to grow given the current sustainability impetus and the necessity of support in the implementation of regulatory requirements. The expected growth is justified by several reasons:

- **The growth in demand from investors in ratings of companies for their investment decisions**: with SFDR, ESG in MiFID, CSRD and ESG Pillar 3 the demand for more granular ESG data on individual companies will rise. Moreover, certain ESG passive funds follow ESG indices which rely heavily on ESG ratings. Investors' interests in sustainable investments and engagement are already booming and standardization, harmonization and transparency will be needed to level the playing field amongst all participants.
- **Growth in demand from companies in ratings including on rating future strategies:** CSRD and, potentially, taxonomy extension will require the definition and publication of transition plans at activity and entity levels. ESG ratings have increasing importance for issuers potentially impacting their access to financing and pricing.
- **Further standardization of information disclosed by companies and other market participants**: pursuant to the application of SFDR, CSRD and Pillar 3 ESG, the disclosure of sustainability information will be standardised and enhanced, thereby enhancing the reliability of ESG ratings by supporting an improved analytical work. In fact, the availability of new and cleaner data from issuers would facilitate price discovery and could possibly mitigate systemic market risk.
- ESG ratings are also needed to structure financial products (including for the management of benchmark, for example.
- The use of ESG ratings **for ESG-related financial risk management purposes** will increase.
- Banks that are covered by the Corporate Suatainability Due Diligence Directive may use ESG ratings to assess the performance of their clients. However, it is important to notice that a problem could arise because of the different focus on impact materiality and financial materiality: indeed, the CSDD focuses on impact materiality for which ESG rating agencies have developed less services.
- **Transparency of methodology and quality of data requirements** will be having a decisive role.

Are you considering to use more ESG ratings in the future?

- Yes, to a large degree
- Yes, to some degree
- No
- No opinion

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

- Comment box: Some banks might be using more ESG ratings in the future, while others mentioned they would rather favour their own internal ESG scoring. Financial products with sustainable characteristics will become more and more common given the current and future regulatory framework (The MiFID II delegated act that will enter into force in August 2022, will include the new sustainability preferences regime). Moreover, more and more data will be necessary to be able to answer all the future reporting obligations. Moreover, a growth in the analysis of ESG risks and opportunities is also noticed: ESG benchmarks rely heavily on ESG ratings and ESG ratings coverage is expected to develop (emerging topics like biodiversity, physical risk and just transition remain to be covered by data providers).

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

- Comment box

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

- Exclusively from large market players
- Mostly from larger market players
- Mixed
- Mostly from smaller market players
- Exclusively from smaller market players
- Not applicable

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

Comment box: The most used ESG ratings are those coming from larger market players. Smaller providers generally have a specific regional presence and a specialization on specific data sets.

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

- Yes
- No

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

While on one side there are manystart-ups and fintech companies entering the market and offering new products, on the other it has to be noticed that that the largest ESG ratings providers are owned by non-EU companies/agencies, increasing the level of concentration of US agencies in the market for ESG ratings and data. There is only one large market player headquartered in the EU, therefore if institutions had to rely solely on that player there would be a lack of coverage of ESG ratings and data products.This creates issues related to the availability of data and different cultures in the analysis of ESG factors including subjective and sectorial biases. For instance sectors such as unconventional oil and gas, or weapons, are excluded by US agencies under pressure from investors; or the primary focus of the agency may be on companies located in the same region as the agency.

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

- Comment box

Finally, do you use other types of ESG assessment tools than ESG ratings (e.g.

controversy screening, rankings, qualitative assessments, etc.)?

- Yes
- No

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?

Comment box: While ESG ratings focus on financial materiality, banks also use products that focus on impact materiality. The importance of these products is also likely to increase because of the CSDD, for example. Financial institutions can use other types of ESG assessment tools (besides the green taxonomy). Few examples are Controversy Activity Screening, Sustainable Development Goals (SDG) Assessments or Corporate ESG Assessments and Scores.
However, these products are less well developed. They are rarely aligned with the OECD Guidelines and the UNGPs, and almost never based on input from affected stakeholders. Financial situations also rely on independent ESG experts to assess, for example, their commitments towards sustainability.

Do you believe that due diligences carried out by users of ESG research are sufficient to ensure an acceptable level of quality?

- Yes
- No

If you replied 'no' to the previous question, would you see merit in refining the current definition of research under Directive 2014/65/EU1?

Comment box: Research providers are not providing for the required in-dept research on due diligence.Moreover, it is fair to assume that existing providers generally have insufficient capabilities to carry out due diligece in line with requirements and expectations.
Moreover, the meaning of "ESG research" is not clear as it is not defined in this consultation. Supposing that the meaning is linked to ESG ratings, data & assimilated services, due digligence research is insufficient because:

- This kind of research is difficult to carry out given the lack of transparency of the ESG data and rating marke;
- The fact that users may be able to conduct due diligences might lead to ESG services providers being exempted from accountability for their services. An EU legislative initiative would be welcome in that respect.

Moreover, Unsolicited ratings are very often based solely on publicly available information (research methodology known solely to the agencies posing a question as to its reliability or transparency and management of conflict of interests) that is not sufficient to provide a fair assessment of an entity. In addition, very often the lack of publicly available ESG information is considered by the agency as a disadvantage to the company, resulting in an unfairly lowered ESG rating. Hence, we see a room for legislative action, perhaps in Directive 2014/65/EU but perhaps in other legislation (not dedicated to issuers only).

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?

Comment box: No, maturity and comparability levels of ESG research products are fundamental to allow users to fully understand the products they are using. However, this realm still shows great margin for improvement: more transparency on used methodologies, data sources and conflict of interests is required as well as the adoption of good practices' standards. With regard to **maturity**, ESG research products need to keep up with regulatory developments, in particular by developing methodologies and by identifying reliable data points to support analysis on broader ESG topics such as biodiversity. Moreover, ESG research products should also focus more on impact analysis. It is therefore necessary that financial institutions are provided with more data on these topics in order to be able to offer corresponding products.

Furthermore, the coverage of asset classes needs to be broadened since data provided is very limited or non-existed, for instance on real estate, sovereigns or illiquid.

As more qualitative and quantitative ESG data will be provided by companies, with the CSRD becoming effective, and with products becoming more transparent because of the SFDR, EET and EuGBS, the the scope of products and companies assessed is expected to further grow. However, the current supply of rating products favours investor-paid products such as MSCI over issuer-triggered ratings.

ESG aspects are also slowly getting integrated in CRA ratings. Even though there is so far no significant impact, this is expected to change over time. The level of integration between classic ESG ratings and the CRA impact is not yet fully transparent and needs to be developed further.

[1] OJ L 173, 12.6.2014, p. 349–496, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32014L0065

II. 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 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.

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

- Well
- Not well

Please explain

Comment box:

- The market is still **too fragmented** and based too much on information sources from third-party companies (sometimes very small, with limited cases, and therefore not very reliable).
- The rating providers apply **very different methodological approaches** that sometimes are not clear and transparent. This reduces the value of ESG ratings and makes investors use them with discretion.
- It is difficult to understand the methodology behind a specific ESG rating as ESG rating providers consider the **methodologies proprietary information**.
- The **reliability of information** is questionable as the information that is used is mostly based on company reports/data. If the data is not available it is estimated by the provider.
- This lack of information is a clear limit to well a functioning market. The European Single Access Point (ESAP) proposed by the Commission is an interesting idea because it will ease the access to ESG data. Nevertheless, the question of who will access the portal should be asked. If anyone, including non-EU ESG data providers can access, with no fees, then European companies risk paying for an information that providers can access freely. It is necessary that non-Eu ESG rating providers cannot access freely the ESAP. The Commission must keep in mind that most of the ESG rating providers are not European but American.
- The current ESG Rating offering **is not transparent enough**, market participants confuse them with credit ratings which is problematic due to limited comparability of rating approaches.
- The focus of data is **still on exclusions and relative ESG performance**. More focus and data on positive impact and impact materiality would be necessary. Moreover, these ratings / products should be aligned to international standards to make them usable for the purpose of Article 18 Taxonomy Regulation.

- **Information is not disclosed to the public** but provided to subscribers only. This produces situations where market prices may be manipulated.
- ESG ratings today nearly always **favour large companies and start-ups**. There should be better balance.
- **Communication policies** implemented by the ESG rating agencies are not yet consolidated. Normally, changes to ESG ratings are not shared with the rated entity (rating unsolicited), which means that the issuer is unaware of the rating change.
- ESG rating/research providers are also heavily characterized by **diverging outcomes.**
- Finally, there is a risk **of dependency upon a limited number of non-European providers,** and potential conflicts of interest. This concentration trend may lead to high price increases for the data, can generate potential conflicts of interest and be detrimental to European sovereignty.
- The question of intellectual property is a problem because a company is not allowed to share with its subsidiaries data that it bought from a provider. This situation makes the access to data difficult for companies.
- Lack of transparency (fairness) and of a common standardisation of ESG ratings leads to a higher reputational risk of ESG providers, because participants may choose only such agencies that will give them good results and not those, who will provide them with a full evaluation of their risks;
- Entities receiving ESG ratings should be aware of the fact that they might have their ESG rating issued by the agency, hence the agency should contact them in advance and give them a possibility to provide additional documents or information allowing verification of publicly available information.

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)?

- Lack of transparency on the operations of the providers 9
- Lack of transparency on the methodologies used by the providers 7
- Lack of clear explanation of what individual ESG ratings measure 7
- Lack of common definition of ESG ratings 8
- Variety of terminologies used for the same products 7
- Lack of comparability between the products offered 7
- Lack of reliability of the ratings 7
- Potential conflicts of interests 5
- Lack of supervision and enforcement over the functioning of this market 7
- Other: 8

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

Comment box: Lack of alignment with international standards (OECD Guidelines, UNGPs) for ratings that focus on impact materiality, lack of transparency about information gaps (e.g. for companies active in countries with restricted civic space), lack of active outreach to affected stakeholders / civil society, substantive concerns about what 'good' E, S, or G means.
The various methodologies used by ESG rating providers make the comparison and the comprehension of ESG rating difficult. As approaches are different (some providers use controversy screening methods while other base their rating on the strategy of the assessed companies) results differ. Companies are usually forced to pay extra fees to access the methodology and be able to understand their results.
Moreover, most of the time, if not always, training is needed to understand the results of a rating. It can be burdensome for some companies to pay for a service and then pay to understand the service. Not being able to understand the result of a rating is problematic.

Other problems relate to the licensing models and contractual/commercial terms:

- ESG services providers have great market power and can unilaterally set contractual conditions, based on their non-EU jurisdiction, due to the current dependency of users on them.
- ESG services providers have opaque pricing and licensing frameworks;
- The offers are "bundled" which obliges to purchase one set of data/services even when needing only a piece of it.
- Strict and expensive limitations to be able to reuse the data.

Therefore, contractual commercial terms should be established on a fair, reasonable, non-discriminatory and transparent (FRANDT) basis.

Important to consider are also the following problems:

- ESG ratings cannot be directly considered in financial analysis
- ESG ratings are not available for small and/or medium sized companies
- Lack of unification of data collection for ESG ratings
- Lack of comparability between different providers
- Some evaluations are time-consuming and not ready to react to actual situation
- Some agencies may be politically dependent and therefore, their evaluations may not be reliable
- ESG ratings are mostly available on commercial terms, hance, their availability to investors is limited.

What do you think of the quality of the ratings offered on a scale from 1 (very poor) to 10 (very good)? 5

Please explain why:

Little coherence in methodologies and calculation methods across ESG rating providers such as the different weight of factors. This can heavily influence the assessment outcomes.

- Even though high-level details are known, there remains a limited transparency of methodologies and the rating process itself
- Moreover, the lack of regulation makes the methodologies difficult to understand: there is a clear lack of transparency, understandability and comparability in the rating provided.
- The comparability of ratings is limited by having both absolute and relative assessments in the market
- The sources of data used is often not clear
- Analysts cover hundreds of companies and fo not have the capacity to thoroughly analyze the company in depth
- ESG ratings are often automated and can include limited human analysis. This might be necessary in complex industries such as finance. Moreover, especially in relation to banks, there is a knowledge shortfall on topics of law, regulation and basic banking principles.
- The quality of the dialogue has an important impact on the quality of the rating. A regular dialogue will enable the provider to understand specificities of the company and the analysis would be likely to be better. The quality and intensity of dialogue is not the same from one provider to another.
- Most ESG ratings focus on topics that are financially material only to a limited and varying extent. Hence, they only partly ensure the integration of ESG risks into investment and financing decisions.
- There is a gap between expectation and reality of ESG ratings such as having an ESG risk compared to an evaluation on the "greenness/ESGness" of a company. In fact, ESG ratings do not always take into account the impact and focus of an organization on the environment (double materiality) and a gap between some investors' expectations (e.g. of retail investors) and real impact continues to exist.
- The risk of an oligopolistic situation where most ESG data vendors are controlled by large Market Data companies or benchmark administrators reduces competitiveness, creates dependencies and hinders ESG benchmark developments and hereby quality can be impacted.

If you responded 'very poor' or 'poor' to the previous question, to what degree do you consider that this affect your trust in the products that are offered, on a scale from 1 (no affect) to 10 (affects very much)?

- Answer (scale 1 to 10)

Please explain why

Comment box:
Most of the banks use the rating as a starting point and then asset manager or benchmark providers recheck the information. This double-checking is an important cost for banks.
Banks must be sure that they can rely on the rating they pay for, otherwise they may face risks of litigation and reputation. If the ESG product does not respect the characteristics announced then the bank is responsible, not the provider.
Moreover, it is important to notice that the market is still too fragmented and based on information sources from third-party companies (sometimes very small, with limited cases, and therefore not very reliable). Unlike credit ratings, which are broadly aligned with each other on the same issuer, ESG

ratings can be very misaligned, and this creates confusion as to their reliability. A study by the MIT Sloan Sustainability Initiative found that correlation among traditional credit ratings was 0.92, but for ESG ratings it was much lower at 0.61. Moreover, there is no uniform definition of what an ESG-rating signifies, and it cannot be compared with a credit rating where the ultimate aim is to provide an opinion on the likelihood of timely payment within a range of definitions (regulatory intervention; first dollar default; ultimate loss for investor).

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

- Yes
- No
- No opinion

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

Comment box:

Currently , the quality of the output and the opacity of the rating methodologies lead to quite significant differences in the final ratings, thus creating confusion for users. This reduces the value of ESG ratings and makes investors use them with discretion.

It is difficult to understand the methodology behind a specific ESG rating as ESG rating providers consider the methodologies proprietary information. There is limited transparency of methodologies and of the rating process: while high level of details is known, guidance on sources is missing. The reliability of information is questionable as the main tools used to make the assessments are those that can be easily retrieved and are publicly available. The information that is used is mostly based on company reports/data, foot printing data. If the data is not available it is estimated by the provider. ESG rating/research providers are also heavily characterized by diverging outcomes, implicitly offering different views on the same data and events with extraordinary low correlations for governance. A company may be considered very high risk, medium risk and low risk at the same time when rated by three different agencies.

Sometimes the rated entity is not allowed to know the resulting rating. In other cases, certain information is disseminated without informing the rated entity. In general, information is not disclosed to the public but provided to subscribers only. This produces situations where market prices may be manipulated. The focus of data is still on exclusions and relative ESG performance. More focus and data on positive impact would be necessary. Finally, there is a risk of dependency upon a limited number of non-European providers, and potential conflicts of interest. An increasing number of European independent providers are being acquired by bigger non-European players (mainly Exchanges and Credit Rating Agencies). This concentration trend may lead to high price increases for the data. The risk of dependency upon a limited number of non-European providers can also generate potential conflicts of interest and be detrimental to European sovereignty. A proposal could be to have non-EU rating agencies to be supervised by ESMA.

Issues also relate to the discrepancies in ESG measurements and ongoing data quality In practice. Indeed, very often ESG ratings are just a list of checks where the availability of certain documentation is seen as proof of real results.

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

- Yes
- No
- No opinion

A low level of correlation can be problematic for rated companies as it increases inconsistencies while comparing a corporate issuer's ESG rating between different ESG rating providers. These inconsistencies are in particular visible with regard to the exposure to controversial businesses such as tobacco production for example. Here, a higher revenue exposure to tobacco did not correlate with lower ESG ratings. ESG ratings are therefore not always an adequate source to determine investment. Other factors need to also be considered in detail.

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)?

Comment box: 8 A low correlation level between various types of ESG ratings can cause problems in terms of comparability: this could be detrimental to the rated company depending on the rating to which investors or external stakeholders consider. Moreover, investors can be misleaded by non correlated ratings and thisdoesn't help them assessing their investment decisions. Moreover, as the rating chosen can vary from a provider to another there is a clear risk of litigation and of reputation. The rated company can also choose a better rating from a provider A and an external party can choose a lower rating from a provider B.

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)

- There is a lack of transparency on the methodology and objectives of the respective ratings 7
- The providers do not communicate and disclose the relevant underlying information 7
- The providers use very different methodologies
- ESG ratings have different objectives (they assess different sustainability aspects) 8

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

Comment box:
A major problem for many players remains the pricing policy of the ESG service providers. This can be measured in particular by what we consider as forced sale of data. ESG Agencies do not sell their data individually or in detail. Their price list only contains a few items on data on specific entities or geographies of a company, and overall the pricing and licensing frameworks are opaque. As a result, when a financial company has a portfolio of companies that are present in several locations and/or different sectors, it is obliged to buy the entire global database on these companies. What is worse is that it has to buy the global database without even having the possibility to check the quality of the data beforehand. Finally, ESG service agencies apply strict and expensive limitations to be able to reuse the data. That situation is largely due to the oligopolistic situation where ESG service provider can unilaterally set contractual conditions based on their jurisdictions.

-

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
- Rather negative

Please explain your response to the previous question :

The variety of types of ESG ratings, assessing different sustainability aspects, is a rather positive feature of the market. This is so because it allows to assess with specificity each industry and sustainability aspect. Standards or rules should not undermine the current diversity of methodologies offered by ESG rating providers which is crucial for investors to inform their decision on which ESG data provider(s) to choose, and to which extent they will use such data in their proprietary scoring. Competitiveness needs to be maintained and stricter rules should not result in further concentration of these providers and reduced diversity.
Moreover, From the investor perspective a variety in products being offered is beneficial to the functioning of the market as this also fosters competition and capital market participants can choose best methodology for their investment approach. If clear distinction is made between "impact scores" (double materiality) and "risk scores" (financial materiality) a variety of ratings is rather positive.
Moreover, some specific activities are still performed by European provider, which is positive.
This being said, diversity across ESG ratings is valuable if methodologies and objectives are clearly disclosed and explained.

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)? 4

Comment box: The ESG ratings market is less prone to potential conflicts of interests than for credit ratings. This is so because market leaders such as MSCI or Sustainalytics are paid,and therefore incentivized, by investors and lenders.

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

- 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 the 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

- Comment box

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)?

- Scale from 1 to 10:

3

What barriers do you see for smaller providers?

Entering the market is difficult for smaller providers due to

- required data coverage and analytical capacity;
- methodological complexity;
- market and brand recognition;
- integration with other products such as indices or credit ratings;
- global coverage.
- Niche and smaller providers concentrate on providing specific aspects such as supply chains (Ecovadis) or on more analytics and reporting layer (Clarity AI). Moreover, there is a tendency to rely more on consolidatea and affirmed things.

Other reasons are:

- bigger providers have a bigger network.
- The necessary investment for smaller providers to enter the market are very high because they would need to cover an equally large coverage to ensure they are competitive with large ESG service providers
- The need for significant investments to acquire data collection and technological tools
- Large players have started to disclose publicly their ratings making them a standard for asset owners when measuring their ESG performance. Financial market participants will therefore favour existing standard providers compared to new comers.
- Large ESG providers are usually linked to index providers where the growth in ESG demand is important.
- There is a monopolistic situation of the current large players and no legal framework to mitigate this problem.

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)?

5

In some ways the smaller providers can continue to provide a competitive advantage, by concentrating on niche aspect of ESG rating assessments, supply chains (Ecovadis), or on more analytics and reporting layer (Clarity AI) which are not covered by the larger providers. It is difficult for smaller provider to remain competitive, as a result there are bought by bigger provider

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)?

6 While the offering of a premium charge for ESG data is by no means an inadequate service, the pricing remains high. Publicly disclosed data which is sourced from companies and put together by providers should have a certain pricing cap, while the data that is entirely formulated by the data provider themselves could be priced differently. It seems odd to pay a premium for the collation of data that is already available to end consumers.

In addition, the providers offer different pricing methods – some by package, some by location, some by number of users and some with all three methods comingled. This makes it difficult to understand the true value/price of a single data point or package.Most of the small providers cannot cover their cost and are acquired by bigger providers, therefore fees may be not proportionate. Nevertheless, fees are not proportional to the product bought but depend on the size of the company, its localization the number of users of the product provided.

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

- Yes
- No
- No opinion

If you responded 'no' to the previous question, please specify what you consider should be the minimum information to be disclosed

- Comment box

Non EU agencies' pricing packages and uses of the ratings are opaque and restrictive and it is complicated, if not forbidden, to discuss with them to have clarifications. Fees are not proportional to the product bought but depend on the size of the company, its localization the number of users of the product provided.

The following information on fees should be disclosed:

- A notice period in case of changes to the essential qualities of the contract (such as tariffs) and a provision that this should not be imposed without prior notice by the data providers.
- Provisions on data reuse. A proper framework for intellectual property rights is needed, so that reuse of data after internal processing is possible at reasonable cost. Such a framework would put an end to arbitrary cost overcharges set up by the ESG data provider and would reduce dependencies on the latter. Such provisions should also be included in the information transmitted by the providers
- In addition, EU Authorities should collect annual information on pricing, licenses, costs and revenues per types of ESG data & ratings and ancillary services
- EU authorities would then publish a report on the fees relating to ESG data & ratings and how they evolve over time, and propose corrective action where appropriate

III. 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.

a) Need for an EU intervention

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
- No
- No opinion

Please explain why :

Comment box:

The identified shortcomings and the expected growth in the ESG ratings (and other ESG services) market, as well as increasing reliance on ESG ratings, call for an EU intervention to define a common framework that would impose transparency requirements on ESG ratings agencies and enhance trust in them.
Only at the EU level can such a single, common framework be adopted and enforced in a harmonised manner. However, the EU should also coordinate at global level with international bodies such as IOSCO to avoid duplication and fragmentation of the requirements. IOSCO recommendations [1]should be the baseline of any EU intervention. Furthermore, an EU intervention is necessary to address the issue of EU sovereignty and governance over ESG data at EU level.
The EU has launched a full sustainable finance regulatory regime. It relies on a critical set of sustainable data that are paramount for (i) disclosing sustainable information to investors and reducing greenwashing risks, (ii) applying EU standards (taxonomy, double materiality principles, Pillar 3 disclosures for banks…). The current predominance of unregulated oligopolistic non-EU ESG data & rating providers calls for a strong EU oversight as well as an opening of the market.
To mitigate these risks, it is very important to respond to the growing demand for ESG ratings with adequate supervisory requirements, to ensure their quality, reliability and comparability. It is therefore necessary to standardize methodologies, operational practices and the definition of ESG, as well as their greater transparency and visibility. Specific requirements should also be introduced for ESG rating providers (coverage capacity, strength and presence on the market, internal organization, etc.).

ESG ratings should become more:

- granular and coeherent with SFDR and MiFID II/IDD ESG requirements;
- reliable;
- accessible;
- comparable;
- updated;

[1] IOSCO recommendations (November 2021): https://www.iosco.org/library/pubdocs/pdf/IOSCOPD690.pdf

- usable
- aligned with international standards on responsible business conduct (OECD Guidelines and UNGPs)

In terms of transparency a EU intervention should improve

- Transparency around the source of ESG data (e.g., publicly disclosed, proxies/estimates, primary source of information regarding controversial events, or other proprietary data), and the frequency with which that data is updated);
- Transparency on product methodology in order for users to be able to determine quality and suitability of a product for their particular use case including on changes of methodologies. Transparency also when ESG data and rating providers change their methodologies;
- Transparency on what a particular product is intended to measure (e.g., whether the product is measuring ESG risk or sustainability impact).

Moreover, an EU intervention should imply

- An authorisation regime and minimum requirements regarding the professional background of rating agencies' analyst.
- A differentiation between risk ratings and impact ratings

Finally, an EU intervention should not only apply to ESG ratings but also to ESG or sustainable data.

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

- Non-regulatory intervention (e.g. guidelines, code of conduct)
- Legislative intervention

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

- 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,
- Other measures (please specify).

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

The need to have methodologies that are disclosed and aligned with standards setters such as ISSB and EFRAG is recognized. The EBF also acknowledges the necessity of having a clearer definition of ESG, and greater transparency and visibility. Specific requirements should also be introduced for ESG rating providers (coverage capacity, strength and presence on the market, internal organization, etc.). A strong supervision at the European level, by ESMA for instance, could be useful to make ESG ratings become more granular and coherent with SFDR and MiFID II/IDD ESG requirements, more reliable, accessible, comparable, updated, and usable. And aligned with international standards on responsible business conducts (in case of impact materiality measurement)

Supervision should be progressively and iteratively developed while maintaining market competitiveness and diversity in terms of ESG ratings actors and uses. In fact, ESG data and ratings providers should be supervised at European level / ESMA level in the same way as the existing supervision of financial data and credit rating providers in Europe. In the absence of supervision, an industry led code of conduct and oversight committee could provide a minimum harmonization.

However, the implementation of any mandatory standard is premature. There is a need for an observation period, in the first stage.

Improving transparency on the operations of the provider: the provider should have robust operational and control process in place to ensure a continuous service and provide sufficient detailed information on such processes

Improving transparency on the methodology used by the providers: there is a need of Disclosure requirements on: the main elements of the methodology (key assumptions; models ; homogenisation of analysis criteria; clarification on the respective weighting rules of the E, S and G factors); main source of data used; data collection processes, how missing data are addressed, the methodology for estimation; data quality controls; the integration of national specificities / local ecosystem and rated company specificities into the analysis, including how it is taken into account;

Improving the reliability and comparability of ratings: harmonised disclosure contents and formats would be very helpful; Disclose the procedure to ensure the quality of the analysis and ratings, and the qualification of analysts (including knowledge of the local ecosystem); Introduce requirements for dialogue with the rated company and a right of response of / review by the rated company before the rating is published

Clarifying what is meant by and captured by ESG ratings, to differentiate: A clear definition of what an ESG rating measures is needed. A wide variety of ESG Ratings and other related products are offered to respond to customers' needs.

Therefore, there is a need to ensure clear and consistent use of terminology in ESG ratings: ESG rating should refer to 'ESG Corporate Risk Ratings' or 'ESG Financial Risk Ratings', so as to distinguish them from ESG impact ratings. For the other services, ESG Rating providers should specifically mention the domain to which the product is related e.g carbon risk ratings should not be referred as ESG ratings as the products assess the environmental aspect only.

Improving transparency on the fees charged by the providers: The EU could specify the conditions under which the commercial terms (ie the pricing conditions but also possibly other contractual terms) of ESG ratings and data providers are to be considered as fair, reasonable, non-discriminatory and transparent (FRANDT).In addition, a suggestion could be to adopt reporting requirements for agencies on fees charged to their clients as well as their pricing policies and procedures, including the fees structure and pricing criteria in relation to ESG ratings. In principle, similar fees should be charged for ratings and other ESG-related services with similar features. EU Authorities should collect annual information on pricing, licenses, costs and revenues per types of ESG data & ratings and ancillary services. EU authorities would then publish a report on the fees relating to ESG data & ratings and how they evolve over time, and propose corrective action where appropriate.

Avoiding potential conflicts of interests : it is necessary to disclose policies on management of conflict of interests and their prevention including details of governance and internal controls, and compliance practices. Providing some supervision on the operations of these providers: providers should be registered/authorized and supervised by ESMA (similarly to other regulations).

If you responded ‘other’ to the previous question, please specify the other elements the intervention should focus on

Strengthening the involvement of the rated entities in the rating process: dialogue and right of review before the rating is published

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
- No
- No opinion

Please explain why :

From the point of view of quality control of ESG ratings, it would be good to have some authorization / registration requirement for service providers. This would mean that all ESG rating providers should be supervised by a public authority. However, authorization should not threaten the diversity of ESG rating agencies since it is useful for the investors to have many different angles on ESG.

Such a system would ensure potential standards and subsequently the use of methodologies of a certain quality as well as the sufficient qualification of the providers' staff. Overall, ESG rating providers should be equally regulated as CRA rating providers.

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 toglobal or non-EU investors?

- Yes
- No
- No opinion

Please explain why:

If the service is provided in the EU, then the service provider must be registered in the EU (CSRD consistency)

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

- Yes
- No
- No opinion

Please explain why

Minimum disclosure requirements in particular with regard to the description of methodology, the purpose of the rating, and an overview of information sources are of utmost importance. Transparency is a key factor in order to take an informed decision as well as for understanding ESG rating assessments, in particular with regard to scope, measurements, methodologies used and the weight of indicators. Moreover, methodologies should be disclosed and aligned with standards setters such as ISSB and EFRAG. More precisely, support disclosure requirements are supported on the following topics:

- the main elements of the methodology (key assumptions; models; homogenisation of analysis criteria; clarification on the respective weighting rules of the E, S and G factors);

- main sources of data used;
- data collection processes, how missing data are addressed, the methodology for estimation; data quality controls
- the integration of national specificities / local ecosystem and rated company specificities into the analysis, including how it is taken into account;
- the procedure to ensure the quality of the analysis and ratings, and the qualification of analysts (including knowledge of the local ecosystem
- fees charged to their clients as well as their pricing policies and procedures, including the fees structure and pricing criteria in relation to ESG ratings

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

- Yes
- No
- No opinion

Please explain:

The use of standardised templates would allow for a better comparability between ESG ratings. Potential guidelines should be ambitiously drafted and should orient themselves on sector leaders. However, the use of standardized templates should not be prescriptive in terms of which methodology to use in order to maintain competitiveness and diversity of the offering.

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?

- Yes
- No
- No opinion

If you responded yes to the previous question, please specify what metric you consider should be used to differentiate between providers:

- Total revenue
- Revenue from ESG ratings
- Number of employees
- Other metric(s)
- in the case of providers located outside the EU and not providing services to EU investors but rating EU companies/financial instruments – percentage of EU companies/financial products rated

If you responded 'other metric(s)' please explain which one(s):

Comment box: It is necessary to support the opening up of the market, including to EU players. Smaller providers should be exempted from certain requirements (some of the transparency and conflict of interest requirements, for example)

Should the 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?

- Yes
- No
- No opinion

If you responded yes to the previous question, please specify what metric you consider should be used to differentiate between providers:

- Percentage of EU companies/financial products rated
- Other metric(s)

If you responded 'other metric(s)' please explain which one(s):

- Comment box

b) Costs of an EU intervention

Questions for ESG rating providers

Assume that in order to offer services to investors in the European Union or to rate European companies/financial products, ESG rating providers would be subject to an authorisation or registration requirement. How high would you estimate the one-off cost of applying for such an authorisation/registration? (please provide an estimate in EUR)

- Comment box

In order to increase transparency, there may be considerations to introduce

disclosure obligations on ESG rating providers. This could include, for example, disclosures on websites or annual reports on the operations and methodologies used

by ESG rating providers and/or providing more information on how these methodologies were applied to specific ratings. Please estimate the number of hours needed to produce the following disclosures:

	Disclosures on the operations and methodologies		Additional disclosures in ratings (hours per rating)
	One-off costs (total hours)	Ongoing costs (hours per week)	
Negligible			
Less than 5 hours (but not negligible)			
5 to 9 hours			
10 to 19 hours			
20 to 39 hours			
40 to 79 hours			
80 to 160 hours			
More than 160 hours			

If you chose more than 160 hours in the table above, please provide an indication of how many hours would be needed (for the costs in each column, as applicable). You may also use the following comment box if you wish to provide any further explanations.

- Comment box

What percentage of these costs would be incurred even in the absence of legislation?

0% 1-20% 21%-40% 41%-60% 61%-80% 81%-100%

Do you see any other costs related to providing these disclosures (e.g. adjustment of IT systems, external consultants, etc.)?

- Yes
- No
- Don’t know

If yes, please specify what type of cost and provide an estimate of its amount where feasible:

- Comment box

How many hours per week would you consider necessary to perform tasks that would be linked to fulfilling ongoing supervisory requirements?

- Negligible time

- Less than 5 hours (but not negligible)
- 5 to 9 hours
- 10 to 19 hours
- 20 to 40 hours
- More than 40 hours

If more than 40 hours, please provide an indication of how many hours would be needed: [comment box]

If there were similar conflict of interest provisions introduced for ESG rating providers as in Article 6 and Annex I to Regulation (EU) 1060/2009 (CRA regulation), would you consider the associated costs to be of similar magnitude?

- Yes
- No
- Don't know

Please explain

- Comment box

Do you expect that you would face any further costs as an ESG rating provider as a result of a possible legal framework besides those mentioned above?

- Yes
- No
- Don't know

If yes, please explain what types of costs, whether they would be one-off or ongoing and provide estimates if possible:

- Comment box

Do you estimate that possible additional compliance costs implied by a minimum requirement framework for ESG ratings would be compensated by the benefits of higher quality and more reliable ratings?

- Not at all
- To some extent
- To a reasonable extent
- To a great extent
- No opinion

What other impact(s) of a regulatory and supervisory framework on the operations of ESG rating providers would you see (e.g. potential impacts on competition, SMEs assessed by ratings, users of ratings, sustainable development)?

- Comment box

Questions for supervisors

How many hours of work would you consider necessary to perform tasks that would be linked to granting an authorisation for one ESG rating provider?

- Negligible time
- Less than 5 hours (but not negligible)
- 5 to 9 hours
- 10 to 19 hours
- 20 to 40 hours
- More than 40 hours

If more than 40 hours, please provide an indication of how many hours would be needed

- comment box

How many hours per week would you consider necessary to perform supervisory tasks per ESG rating provider?

- Negligible time
- Less than 5 hours (but not negligible)
- 5 to 9 hours
- 10 to 19 hours
- More than 20 hours

If more than 20 hours per week, please provide an indication of how many hours would be needed

- comment box

PART B – INCORPORATION OF ESG FACTORS IN CREDIT RATINGS

The provision of credit ratings is highly regulated in the EU as well as globally. Global standards are established by the IOSCO in its code of conduct for CRAs. The EU legal framework regulates the activities of CRAs with a view to protect investors and financial markets by guaranteeing the transparency, independence and integrity of the credit rating process – thereby enhancing the quality of ratings. All CRAs operating in the EU need to register with ESMA, which is the sole European supervisor. Credit ratings used for the purposes stemming from the EU legislation need to be provided by CRAs registered and supervised by ESMA. If a non-EU CRA wants its ratings to be used for regulatory requirements in the EU (i.e. by EU financial institutions), the CRA Regulation provides for two alternatives, certification or endorsement.

There are a number of EU regulatory requirements related to the use of credit ratings. , in particular, in the Capital Requirements Regulation (CRR) and in the Solvency Capital Requirement (SCR). The European Central Bank also makes extensive use of credit ratings in its open market operations.

Both EU legislation[2] and the IOSCO code of conduct define precisely the objective ofthe credit rating: 'credit rating means an opinion regarding the creditworthiness of an entity, a debt or financial obligation, debt security, preferred share or other financial instrument, or of an issuer of such a debt or financial obligation, debt security, preferred share or other financial instrument, issued using an established and defined ranking system of rating categories'.

In other words, credit ratings assess the likelihood of the default of the rated entity or security. Credit ratings reply to the question: "what is the likelihood of getting my money back?" They are neither investment recommendations nor they determine the value of the rated entity or instruments.

ESG risks may be relevant for the assessment of creditworthiness depending on the sector, geographical location and the entity itself. CRAs methodologies define which factors, including ESG factors, are considered to be relevant for the assessment ofcreditworthiness and how they are taken into account in the credit rating process. ESMA supervises the soundness of methodologies, which in accordance with the CRA Regulation need to be rigorous, systematic, continuous, based on historical experience and back-tested. In its Technical Advice provided to the Commission in 2019,ESMA concluded that while it is clear that CRAs are considering E, S or G factors in their credit ratings, the extent to which each factor is considered varies by asset class, according to the importance assigned to that factor by a CRA's methodology. Currently, ESMA is conducting a thorough assessment of how CRA's methodologies incorporate sustainability risks.

The CRA Regulation includes a number of disclosure obligations in relation to the methodologies as well as individual credit ratings. In 2019, ESMA conducted a public consultation on disclosure requirements applicable to credit ratings. Following the finding on the insufficient transparency on the relevance of ESG factors to credit ratings, one of the topics of the consultation, ESMA issued guidelines on disclosure requirements applicable to credit ratings.

[2] 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, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32013R0462

These ESMA guidelines expect CRAs to identify in their press releases if ESG factors have been key drivers behind a change in the credit rating. CRAs are asked to identify relevant factors, elaborate on their materiality and provide a reference to the methodology or the associated model. The ESMA guidelines came into effect in April 2020.

A recent assessment of the application of the guidelines revealed that the improvement of transparency has been partial. ESMA has analysed press releases over the period January 2019 – December 2020 and compared the number of references to ESG considerations before and after April 2020. The main findings are that the improvement is partial and not uniform.

This consultation builds on the findings of ESMA and the consultation on renewed sustainable finance strategy.

I. Questions to users of credit ratings

Do you use credit ratings for investment decisions?

- Yes, as a starting point for internal analysis
- Yes, as one of many sources of information that influence investment decisions
- Yes, as a decisive input into an investment decision
- No
- Other

If you use credit ratings for other purposes, please explain :

- [Comment box]

Do you use credit ratings for regulatory purposes (e.g. stemming from the Capital Requirements Regulation or Solvency II)?

- Yes
- No
- These requirements don't apply to me

Is it important for you to understand to what extent individual credit rating actions have been influenced by sustainability factors?

- Not important at all
- Slightly important
- Important
- Very important
- No opinion

Do you find information about the extent to which CRAs methodologies or the rating process incorporate sustainability factors sufficiently well disclosed?

- Yes

- No
- No opinion

Please explain

- [comment box]

Where do you look currently for the information on how ESG factors impact the credit rating? (multiple choice)

- Press release accompanying credit ratings
- Additional analysis and reports available to subscribers
- Additional information materials available publicly
- Description of methodologies or rating process for specific asset classes, sectors or types of entities
- Frameworks or documents describing general approach to incorporation of ESG factors in credit rating process
- I don't know where to find such information
- Other

If you responded 'other' please explain where:

- [Comment box]

Does the level of disclosure differ depending on individual CRAs?

- Yes
- No
- No opinion

If you answered yes to the previous question, please explain the differences in the level of disclosure:

- [Comment box]

What are the trends on the market in relation to disclosure of information as to which credit ratings actions have been influenced by sustainability factors? (multiple choice)

- The level of disclosure has improved sufficiently since the entry into effect of ESMA guidelines (April 2020)
- In general the level of disclosure has improved sufficiently although some CRAs are lagging behind
- The overall level of disclosure is insufficient although some CRAs have sufficiently improved

The extent to which CRAs incorporate ESG factors in credit ratings depends on the asset classes methodologies and the importance assigned to the given factor by a CRA's methodology. In addition, some CRAs have developed overall frameworks explaining how they incorporate ESG factors in credit ratings across asset classes, some publish reports reviewing past credit rating actions or specific sections accompanying credit rating actions.

In your opinion, what are trends in the relation to the incorporation of ESG factors in the credit rating process and methodologies?

- CRAs have sufficiently improved the incorporation of ESG factors in their methodologies and rating process,
- In general CRAs have sufficiently improved the incorporation of ESG factors in credit ratings although some CRAs are lagging behind
- In general the development is insufficient although some CRAs have improved the incorporation of ESG factors in their methodologies and rating process,
- CRAs have insufficiently improved the incorporation of ESG factors in their methodologies and rating process

II. Questions to Credit Rating Agencies

Do you explicitly incorporate ESG factors in your methodologies?

- Yes
- Yes, but only for asset classes and sectors where relevant
- Partially
- No

Please explain your reply

- [Comment box]

Which individual E, S and G factors do you consider in your methodologies? (multiple choice)

- Environmental factors
- Social factors
- Governance factors
- Other – sustainability related factors

Please explain in more details

- [comment box]

In addition to methodologies, do you have a framework or a document describing how you incorporate ESG factors in the credit rating process? By framework, we mean any general approach to the incorporation of ESG factors in credit rating process, in addition to methodologies for asset classes and sectors.

- Yes
- No
- Other

If you answered other, please explain

- [Comment box]

Have you improved disclosure on ESG factors in credit ratings since April 2020 when ESMA guidelines became applicable?

- Yes
- Partially
- No, but we plan to improve
- No, because we have already been disclosing such information
- No

If you replied no to the previous question, please explain why

- [Comment box]

III. Questions on the need for EU intervention (all respondents)

Do you consider that the current trends in the market are sufficient to ensure that CRAs incorporate relevant ESG factors in credit ratings?

- Yes
- No
- No opinion

Do you consider that the current trends in the market and application of ESMA guidelines on disclosure applicable to CRAs are sufficient to ensure understanding among users as to how ESG factors influence credit ratings?

- Yes
- No
- No opinion

If you responded 'no' to the previous questions, what type of intervention would you consider necessary? (multiple choice)

- Further detailing of ESMA guidelines on the disclosure of ESG factors in credit ratings
- Further supervisory actions by ESMA
- Legislative intervention.
- While improvements are insufficient, we do not see further scope for EU intervention
- Other, please specify

Following the guidelines adpted by ESMA in 2020 on disclosure requirements for credit ratings and rating outlooks, CRAs took measures to improve transparency in integrating ESG factors into their credit rating methodology. To recognise the needs of shareholders for greater clarity on how ESG factors are integrated in credit analysis, CRAs committed themselves into providing more specific ESG frameworks. Even though considerable efforts have been made insofar, there are still improvements to be made in terms of homogeneity of frameworks across different CRAs.

Due to the increasing potential of Environmental, Social, and Governance risks and opportunities have to affect creditworthiness, we understand that an improved, more effective and transparent integration of ESG factors in the credit rating procedure is strongly recommended.

Despite the efforts undertaken to evaluate the extent to which ESG factors are relevant and the way in which these factors are considered in credit ratings, their overall impact and materiality relies upon the decision of each CRA.

In most cases it is considered quite ineffective because the ESG factors do not really represent a key driver of the credit ratings and as such credit ratings should not be understood as providing an opinion on sustainability characteristics of an issuer or entity.

Transition risk was underestimated as a risk driver in the past, so further work is also merited on that regard, as well as equating the time horizons with forward-looking risk perspectives that also integrate physical risk as a relevant factor.

If you responded 'other' to the previous question, please specify the other type of intervention you consider necessary:

- Comment box

Credit rating agencies should be audited and / or supervised. This "control" aspect would be a good lever to ensure a proper building of robust methodologies (potentially more homogeneous).

Regarding the possible regulatory intervention, what type of requirements do you find relevant? (multiple choice)

- Press releases: introduce mandatory requirements mirroring the provision of ESMA guidance on the disclosure ESG factors in credit ratings
- Press releases: in addition to the previous option require CRAs to publish information not only about the impact of ESG factors on credit ratings, but also the lack of it,
- Methodologies: require CRAs to explain the relevance of ESG factors in methodologies,
- Methodologies: require CRAs to take into account ESG factors where relevant.
- Other.

If you responded other, please explain:

- [Comment box]

What kind of risks or merits of the EU intervention do you see?

- Provide further clarity on the impact of ESG factors on the creditworthiness of creditors and financial instruments
- More coherent approach of CRAs to the incorporation of ESG factors into credit ratings
- Concerns about too much prominence given to ESG factors
- Others

If you responded 'others', please explain:

[Comment box] Both CRAs and ESG factors should be well-balanced and should provide a more holistic view of a company. Both factors should be interconnected to improve the overall stability of the assessments.

What would be the consequences of the lack of the EU intervention? (multiple choice)

- Market trends are sufficient to meet investors demands for information on the impact of ESG factors on credit ratings
- CRAs will respond to market pressure and ensure the incorporation of ESGfactors in credit ratings
- The existing gap between approaches of CRAs to the incorporation of ESGfactors in credit ratings will grow
- Concerns about the insufficient incorporation of ESG factors in credit ratings lack of understanding among investors why certain credit rating actions are not impacted by ESG factors

Costs of EU intervention - questions for CRAs

Where applicable, what are your costs in EUR to disclose information based on the current Guidelines on disclosure of ESG factors in credit ratings?

[Comment box]

Would you foresee any additional compliance costs if the current Guidelines on disclosure of ESG factors in credit ratings were to become part of the EU legislation?

[Comment box]

To what degree do CRAs overall already follow the guidelines in the absence of an obligation to do so?

- 0% 1-40% 41%-60% 61%-80% 81%-90% 91%-99% 100%

Would you expect additional compliance costs if EU legislation explicitly required CRAs to take into account ESG factors where relevant in the rating process?

- No or negligible additional costs
- Low additional costs
- Moderate additional costs
- High additional costs
- Do not know

If you do expect additional compliance costs, how high would you expect these additional costs, as compared to current practice?

- [Comment box]

Please explain

- [Comment box]