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Targeted consultation on the functioning of the ESG ratings market in the European Union and on the consideration of ESG factors in credit ratings

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.

3. Questions for all respondents

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

- Yes
- No
- No opinion

Reply: Yes

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
- Growth in demand from companies in ratings including on rating future strategies
- Further standardisation of information disclosed by companies and other market participants
- Other

Reply: N/A

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

- Comment box

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

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

Reply: N/A

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

- Comment box

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

Reply: N/A

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

- Comment box

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

- Yes
- No
- No opinion

Reply: N/A

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

- Comment box

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

Reply: N/A

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

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

- Yes
- No

Reply: N/A

If you replied ‘no’ to the previous question, would you see merit in refining the current definition of research under [Directive 2014/65/EU](#)¹?

- Comment box

Reply: N/A

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

Reply: The Commission’s study on sustainability related-ratings, data and research published in January 2021 highlighted that there were several issues with the ESG ratings market, in particular on transparency regarding data sourcing and methodologies.

Further transparency is needed if users are to fully understand the ESG rating products.

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.

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

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

Reply: There are several issues with the ESG ratings market, in particular on transparency regarding data sourcing and methodologies. Furthermore, methodologies and scoring differs vastly between different ESG-rating providers.

A deeper understanding of these issues is warranted if regulators are to address the risk of green washing, capital misallocation and other risks that may stem from the ESG ratings market in the future.

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

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

- Comment box

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

- Scale

Reply: N/A

Please explain why:

- Comment box

If you responded ‘very poor’ or ‘poor’ to the previous question, to what degree do you consider that this affects 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

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

- Yes
- No
- No opinion

Reply: N/A

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

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

- Yes
- No

- No opinion

Reply: N/A

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

Reply: N/A

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
- The providers do not communicate and disclose the relevant underlying information
- The providers use very different methodologies
- ESG ratings have different objectives (they assess different sustainability aspects)
- Other issue(s)

Reply: N/A

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

- Comment box

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

Reply: N/A

Please explain your response to the previous question:

- Comment box

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)?

- Comment box

Reply: N/A

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

Reply: N/A

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

Reply: N/A

What barriers do you see for smaller providers?

- Comment box

Reply: Cost to establish the necessary data framework could be a considerable barrier to entry for smaller providers. A lack of reputation could also constitute a barrier for entry for smaller providers.

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)?

Reply: N/A

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)?

- Scale

Reply: N/A

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

- Yes
- No
- No opinion

Reply: N/A

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

- Comment box

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

Reply: Yes

Please explain why:

- Comment box

Reply: An intervention could foster transparency and comparability across ESG-rating providers thus providing to a better functioning of the ESG-ratings market.

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

Reply: N/A

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).

Reply:

- Improving transparency on the operations of the providers
- Improving transparency on the methodology used by the providers
- Improving the reliability and comparability of ratings.

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

- Comment box

Reply: A deeper understanding of the challenges mentioned above is needed if regulators are to address the risk of green washing, capital mis-allocation and other risks that may stem from the ESG ratings market in the future.

Specific recommendations for policy solutions also need to be based on a thorough understanding of the challenges in the market for ESG-ratings. Therefore, proposals for solutions should await the current impact assessment.

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

- Comment box

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

Reply: N/A

Please explain why:

- Comment box

Reply: N/A

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

- Yes
- No
- No opinion

Reply: N/A

Please explain why:

- Comment box

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

- Yes
- No
- No opinion

Reply: N/A

Please explain why:

- Comment box

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

- Yes
- No
- No opinion

Reply: N/A

Please explain:

- Comment box

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

Reply: N/A

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

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

Reply: N/A

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 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

Reply: N/A

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

Reply: N/A

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

- Comment box

Reply: N/A