association of the luxembourg fund industry

Luxembourg, 2 June 2022

ALFI response to the EC targeted consultation on the functioning of the ESG ratings market in the European Union and on the consideration of ESG factors in credit ratings

Introduction

The Association of the Luxembourg Fund Industry (ALFI) represents the face and voice of the Luxembourg asset management and investment fund community. The Association is committed to the development of the Luxembourg fund industry by striving to create new business opportunities, and through the exchange of information and knowledge.

Created in 1988, the Association today represents over 1,500 Luxembourg domiciled investment funds, asset management companies and a wide range of business that serve the sector. These include depositary banks, fund administrators, transfer agents, distributors, legal firms, consultants, tax advisory firms, auditors and accountants, specialised IT and communication companies. Luxembourg is the largest fund domicile in Europe and a worldwide leader in cross-border distribution of funds. Luxembourg domiciled investment funds are distributed in more than 70 countries around the world.

We thank the European Commission for the opportunity to participate in this targeted consultation on the functioning of the ESG ratings market in the European Union and on the consideration of ESG factors in credit ratings.

Response to the consultation

Part A – ESG Ratings

I. USE OF ESG RATINGS AND DYNAMICS OF THE MARKET

1. QUESTIONS FOR INVESTORS, ASSET MANAGERS AND BENCHMARK ADMINISTRATORS

(Selection)

What do you value and need most in ESG ratings?

Please select as many answers as you like

☒ transparency in data sourcing and methodologies

☒ timeliness, accuracy and reliability of ESG ratings

☐ final score of individual factors

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☐ 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:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Please explain your answer:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Although the consultation paper focuses on ESG ratings, we believe it is also important to make clear the distinction between ESG ratings, ESG indicators (such as the indicators defined under SFDR (PAI) or Taxonomy alignment) and underlying ESG raw data (i.e. the ESG data points used in order to calculate ESG ratings and ESG indicators).

ESG data

With an increasing number of mandatory ESG indicators imposed by SFDR/TR and managers increasingly opting for proprietary ESG analysis tools, the availability/coverage, the up-to-dateness and reliability of ESG data and ESG indicators are of increasing relevance and key concerns to the industry.

ALFI is of the view that the availability and reliability of ESG data points to calculate these indicators required by SFDR/Taxonomy (PAI, TSC, DNSH...) and comply with asset managers' own regulatory requirements are crucial. Asset managers are really struggling in getting this ESG data as, for many of them, these data points are often not available, incomplete or unreliable.

In this context, another key concern is the transparency of calculated ESG data points (methodology, proxies, data sources, etc) provided by 3rd party data providers. These issues are exacerbated by the information sequencing gap, where issuing companies will start providing relevant non-financial information several years after asset managers are called to make disclosures in absence of information coming directly from companies. As a result, recent pieces of regulation have inadvertently created inelastic demand for ESG data. CSRD will only cover a certain scope of companies either based in the EU or related to the EU market, but not all portfolio companies. For data not covered under CSRD, asset managers will continue to rely on 3rd party providers and their assessments.

Focus shall be in ensuring that investee companies report these ESG data points and that the data is available in a centralised, structured, and digital way (API) through the ESAP project or alike initiatives, while focusing scrutiny on the reliable data delivery by reporting entities irrespective of the finally chosen centralizing data venue. The appropriate quality checks should be embedded in the databases (or the supporting documentation/elements to perform data quality checks) so that all relevant stakeholders can validly rely on data made available by investee companies.

<u>ESG Indicators</u> (SFDR/Taxonomy)

Financial market participants/asset managers use multiple sources of information and data vendors for their needs under SFDR and TR, as well as information they need to provide to the end investors either directly or via distributors and intermediaries. Some of our members have identified very significant divergences in the PAI indicators, Taxonomy eligibility and -alignment percentage reported by different ESG data providers. ESG data providers are indeed compensating the lack of ESG data reported by underlying companies by using estimates (based on peers or sectoral data) or, in the absence of data points required by the regulators, some data vendors are using proxy methodology. We are deeply concerned by the delay in getting comprehensive, reliable and transparent ESG data supporting robust and transparent ESG indicators calculation and the resulting reporting risks in the intermediate period.

With regard to the processes and methodologies used by rating agencies, we would like to highlight that these should be transparent. This should also address the needs of retail investors that pay close attention to ESG ratings and may base their investment decisions on them. It should be transparent to investors what ESG ratings and their measures entail, how they are being carried out, based on which data and as how reliable the data used can be considered.

Rating providers should disclose, in short, the methodology for their rating approach (as required under SFDR draft RTS for Financial Market Participants) and its limitations as well as the methodology for their normalisation approach to rating scales to highlight possible bias in the ratings.

A code of good practice for ESG rating providers should be considered to be implemented, as a soft law tool or guidance which shall foster the required transparency from a user perspective within this activity. It is also important to have an enforcement system e.g. an independent oversight committee (involving users of ESG ratings) ensuring the enforcement of a transparent and robust regime in terms of methodology and underlying data.

In general, we stress out that the right tools should be in place without jeopardizing the diversity of choice for investors. It is important to have different perspectives in terms of methodology and analysis, as long as there is clarity and transparency on them.

To what degree to you consider the ESG ratings market to be competitive and allows for choice of ESG rating providers at reasonable costs?

(1=not competitive, 10=very competitive)

☐ 1 - not competitive

☐ 2

☐ 3

☐ 4

☒ 5

☐ 6

☐ 7

☐ 8

☐ 9

☐ 10 – very competitive

☐ Don’t know / no opinion / not applicable

Please explain your answer:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

While there are a few different ESG rating providers in the market, we still lack the necessary transparency regarding the underlying methodology and data.

Similarly, we also question the rationale as regards the pricing methods used by these providers, as often it is difficult to understand when and how changes occur.

Therefore, we believe there is still room for further efficiency in this respect.

2. QUESTIONS FOR COMPANIES SUBJECT TO RATINGS

(N/A)

3. QUESTIONS FOR ALL RESPONDENTS

(Selection)

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

☒Yes

☐ No

☐ Don’t know / no opinion / not applicable

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 to 10?

(1 = not at all, 10 = very much)

	1	2	3	4	5	6	7	8	9	10	Don't know/ no opinion / NA
Growth in demand from investors in ratings of companies for their investment decisions								X			
Growth in demand from companies in ratings including on rating future strategies								X			
Further standardisation of information disclosed by companies and other market participants								X			
Other											

Please specify what other reason(s) you see for this market to continue to grow:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

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

☐Yes

☒ No

☐ Don't know / no opinion / not applicable

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

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

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

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

We would like to refer to our response to the question regarding the difficulties for smaller players to enter the market.

In addition, we would like to highlight that in our view, it should not be decisive where the provider is located. The most important aspect is to enable a broad choice of providers. That said, we believe a level-playing-field between EU and non-EU companies should be ensured in terms of transparency and disclosure. At the same time, it is very important that any envisaged regulation/potential supervision does not constitute a barrier for new entrance (of EU and non-EU providers).

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

☒ Yes

☐ No

☐ Don't know / no opinion / not applicable

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?

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

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

☐ Yes

☒ No

☐ Don't know / no opinion / not applicable

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

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

We consider it is non-balanced that the quality check is left to the due diligence and efforts from the users. Instead, we believe that these quality checks should first and foremost come from the rating and data providers together with demonstration of such checks taking place.

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?

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

We would like to refer to our answer to question 1.

In addition, a major issue that goes beyond the question on ESG ratings is a lack of and discrepancies between the transparency shown by data vendors regarding how they developed their findings on taxonomy alignment based on certain raw data (see our comments answering the question1).

Rating agencies very often compensate for the lack of ESG data points disclosed by issuers by using estimates based on peer or sectoral data to rate companies. Such approaches may amount to increased greenwashing risk and could lead some issuers to adopt strategies of publishing (or withholding) information in a way that is to their advantage.

This is a vicious circle because rating agencies are faced with potential clients from the financial world - under pressure to provide various reports - for whom the coverage rate is a determining factor in the choice of a provider, which encourages them to use estimates.

The rather inelastic demand for ESG data created by regulation also gives pricing power to ESG data providers. The “subscriber pays” model can lead to the ESG ratings provider being incentivized to prioritize quantity over quality of data, making the best use of economies of scale and potentially compromising the robustness of the data and analysis in the process. Consequently, another area that we would suggest regulators to currently pay attention to is the concentration and price competition in the market.

However, as financial markets thrive on information, the availability of new and cleaner data from issuers may facilitate price discovery over time. It could eventually also help to mitigate systemic market risk.

II. FUNCTIONING OF THE ESG RATINGS MARKET

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

☐ Well

☒ Not well

☐ Don’t know / no opinion / not applicable

Please explain your answer:

5000 character(s) maximum
including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

We believe timeliness and transparency of ESG ratings are two crucial characteristics of a well-functioning market.

With regard to the processes and methodologies used by rating agencies, we would like to highlight that these should be transparent. This should also address the needs of retail investors that pay close attention to ESG ratings and may base their investment decisions on them. It should be transparent to investors what ESG ratings and their measures entail, how they are being carried out, based on which data and as how reliable the data used can be considered.

Rating providers should disclose, in short, the methodology for their rating approach (as required under SFDR draft RTS for Financial Market Participants) and its limitations as well as the methodology for their normalisation approach to rating scales to highlight possible bias in the ratings.

A code of good practice for ESG rating providers should be considered to be implemented, as a soft law tool or guidance which shall foster the required transparency from a user perspective within this activity. It is also important to have an enforcement system e.g. an independent oversight committee (involving users of ESG ratings) ensuring the enforcement of a transparent and robust regime in terms of methodology and underlying data.

In general, we would like to stress that the right tools should be put in place to improve the functioning of the market without jeopardizing the diversity of choice for investors. It is important to have different perspectives in terms of methodology and analysis, as long as there is clarity and transparency on them.

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)

	1	2	3	4	5	6	7	8	9	10	Don't know/ no opinion / NA
Lack of transparency on the operations of the providers										X	
Lack of transparency on the methodologies used by the providers										X	
Lack of clear explanation of what individual ESG ratings measure										X	
Lack of common definition of ESG ratings	X										

Variety of terminologies used for the same products	X										
Lack of comparability between the products offered		X									
Lack of reliability of the ratings										X	
Potential conflicts of interests								X			
Lack of supervision and enforcement over the functioning of this market					X						
Other								X			

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

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

In this context, another issue that may be addressed is the fact that sudden changes on governance practices by rating agencies may not always allow for proper/timely reaction, identification, and correction of errors/misalignments.

We believe the lack of supervision should be mitigated by a soft law approach (as mentioned in our response under question 1). The implementation of a code of good practice for ESG rating providers should be considered, as a soft law tool or guidance which shall foster the required transparency from a user perspective within this activity. It is also important to have an enforcement system e.g. an independent oversight committee (involving users of ESG ratings) ensuring the enforcement of a transparent and robust regime in terms of methodology and underlying data.

In general, we would like to stress that the right tools should be put in place to improve the functioning of the market without jeopardizing the diversity of choice for investors. It is important to have different perspectives in terms of methodology and analysis, as long as there is clarity and transparency around them.

What do you think of the quality of the ratings offered, on a scale from 1 to 10?

(1=very poor, 10=very good)

☐ 1 – very poor

☐ 2

☐ 3

☐ 4

☒ 5

☐ 6

☐ 7

☐ 8

☐ 9

☐ 10 – very good

☐ Don’t know / no opinion / not applicable

Please explain why:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

It is difficult to give a general answer that covers all rating providers, as the quality of the rating depends on different aspects such as the type of rating provided and the respective need by asset managers.

The concept of ‘ESG’ is not globally defined (the EU could take the lead on the definition). As a result, there is not a high degree of correlation between core ESG agencies for the same assets: a fund or a company rating can differ greatly between agencies as each one of these use their own definitions, methodologies and standards to create their score/rating scale.

Nonetheless, it can prove challenging to strike the right balance between serving correlation and not enabling a too generic approach.

It should not be disregarded that sustainability factors and their relevance or materiality for the respective stakeholder can differ and can be multi-faceted. These factors cannot in a one-size-fits-all approach be distilled into one single metric. Such an approach could bear a systemic risk of large simultaneous outflows in case of bad ratings.

We understand in this context that some asset managers/funds have opted for proprietary tools to allow them to perform their own analysis based on their individual assessment of relevant aspects. Accordingly, we believe that while seeking correlation, a certain level of differentiation and flexibility should also be maintained when regulating providers of ESG rating.

Furthermore, as mentioned above, the processes and methodologies used by rating agencies should be transparent. This should also address the needs of retail investors that pay close attention to ESG ratings and may base their investment decisions on them. It should be transparent to investors what ESG ratings and their measures entail, how they are being carried out, based on which data and as how reliable the data used can be considered.

Rating providers should disclose, in short, the methodology for their rating approach (as required under SFDR draft RTS for Financial Market Participants) and its limitations as well as the methodology for their normalisation approach to rating scales to highlight possible bias in the ratings.

A code of good practice for ESG rating providers should be considered to be implemented, as a soft law tool or guidance which shall foster the required transparency from a user perspective within this activity. It is also important to have an enforcement system e.g. an independent oversight committee (involving users of ESG ratings) ensuring the enforcement of a transparent and robust regime in terms of methodology and underlying data.

In general, we stress out that the right tools should be in place without jeopardizing the diversity of choice for investors. It is important to have different perspectives in terms of methodology and analysis, as long as there is clarity and transparency on them. We also note that some ratings lack a detailed analysis.

A further issue that may be addressed in this context is that sudden changes in governance practices by rating agencies may not always allow for proper/timely reaction and correction of errors/misalignments.

Despite the challenges identified, we recognize that the risk of misrepresentation regarding the extent and importance of ESG ratings and related indicators in investment processes may lessen over time as disclosure standards in Europe improve.

While ESG ratings may inform trading decisions, the diversity of ESG ratings and related indicators in use for this purpose allows for selection, which somewhat protects against herd behaviour and related market discontinuities.

Nonetheless, we remain concerned about the time it will take to fully develop the taxonomy across EU sectors and address social objectives. Quality, completeness, accessibility, and reliability of non-financial data reported by corporates also negatively impact the availability of ESG data.

Finally, the risk of conflict of interest between ESG scoring agencies and their parents is another issue that may deserve attention.

If you responded ‘very poor’ or ‘poor’ to the previous question, wo what degree do you consider that this affect your trust in the products that are offered, on a scale from 1 to 10?

(1=no impact, 10=very high impact)

☐ 1 – no impact

☐ 2

☐ 3

☐ 4

☐ 5

☐ 6

☐ 7

☐ 8

☐ 9

☐ 10 – very high impact

☐ Don’t know / no opinion / not applicable

Please explain why:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

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

☒ Yes

☐ No

☐ Don't know / no opinion / not applicable

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

☐ Don't know / no opinion / not applicable

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

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Biases exist based on different factors like availability of data, approach chosen (some providers do not consider double-materiality, but only the impact of the environmental changes on a company) and dependencies (larger non-EU providers are buying smaller European ones).

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

☒ Yes

☐ No

☐ Don't know / no opinion / not applicable

Please explain your answer to question 1:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

The concept of ‘ESG’ is not globally defined (the EU could take the lead on the definition). As a result, there is a not a high degree of correlation between core ESG agencies for the same assets: a fund or a company rating can differ greatly between agencies as agencies would be using their own definitions, methodologies and standards to define their score/rating scale.

Nonetheless, it can prove challenging to strike the right balance between serving correlation and not enabling a too generic approach.

It should not be disregarded that sustainability factors and their relevance or materiality for the respective stakeholder can differ and can be multi-faceted. These factors cannot in a one-size-fits-all approach be distilled into one single metric. Such an approach could bear a systemic risk of large simultaneous outflows in case of bad ratings.

We understand in this context that some asset managers/funds have opted for proprietary tools to allow them to perform their own analysis based on their individual assessment of relevant aspects. Accordingly, we believe that while seeking correlation, a certain level of differentiation and flexibility should also be maintained when regulating providers of ESG rating and ESG indicator calculations.

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 to 10?

(1=no problem, 10=significant problem)

☐ 1 – no problem

☐ 2

☒ 3

☐ 4

☐ 5

☐ 6

☐ 7

☐ 8

☐ 9

☐ 10 – significant problem

☐ Don’t know / no opinion / not applicable

Please explain your answer:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Reference is made to our answer above."

How much do you consider each of the following to be an issue, on a scale from 1 to 10?

(1=no issue, 10=very significant issue)

	1	2	3	4	5	6	7	8	9	10	Don't know/ no opinion / NA
There is a lack of transparency on the methodology and objectives of the respective ratings										X	
The providers do not communicate and disclose the relevant underlying information										X	
The providers use very different methodologies	X										
ESG ratings have different objectives (they assess different sustainability aspects)	X										
Other issue(s)											

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

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

We would like to refer to our answers above.

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

☐ Don't know / no opinion / not applicable

Please explain your answer:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

While ESG ratings may inform trading decisions, the diversity of ESG ratings and related indicators in use for this purpose allows for selection, which somewhat protects against herd behaviour and related market discontinuities.

To what degree do you consider this market to be prone to potential conflicts of interests, on a scale from 1 to 10?

(1=very much, 10=very little)

☐ 1 – very much

☐ 2

☐ 3

☐ 4

☐ 5

☐ 6

☐ 7

☒ 8

☐ 9

☐ 10 – very little

☐ Don’t know / no opinion / not applicable

Please explain your answer:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Reference is made to above responses.

If you consider that this market is very much prone to conflicts of interests, where do you see the main risks?

Please select as many answers as you like

☐ 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:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

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)

☐ 1 – hard to enter

☐ 2

☐ 3

☒ 4

☐ 5

☐ 6

☐ 7

☐ 8

☐ 9

☐ 10 – easy to enter

☐ Don’t know / no opinion / not applicable

Please explain your answer:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

As there is a tendency for companies and investors to seek the largest possible coverage, the market is currently dominated by a few big players. Therefore, rendering it difficult for smaller ESG rating providers to establish themselves. We are afraid this may also negatively impact the product choice available.

Finally, referring to our response above, we would like to highlight that it is very important that any envisaged regulation/potential supervision does not constitute a barrier for new entrance (of EU and non-EU providers).

What barriers do you see for smaller providers?

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Reference is made to our above responses.

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 to 10?

(1=does not allow, 10=fully allows)

☐ 1 – does not allot

☐ 2

☒ 3

☐ 4

☐ 5

☐ 6

☐ 7

☐ 8

☐ 9

☐ 10 – fully allows

☐ Don’t know / no opinion / not applicable

Please explain your answer:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Reference is made to our responses above.

To what degree do you consider the fees charged for ESG ratings to be proportionate to the services provided, on a scale from 1 to 10?

(1=not proportionate, 10=very proportionate)

☐ 1 – not proportionate

☐ 2

☒ 3

☐ 4

☐ 5

☐ 6

☐ 7

☐ 8

☐ 9

☐ 10 – very proportionate

☐ Don't know / no opinion / not applicable

Please explain your answer:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

From a users' perspective a more structured and justified policy would be useful, especially, given that we are currently experiencing that fee policies do not directly adapt to enhancement or changes in the services offered.

Finally, we also are concerned that the regulatory demand for data has become a fee policy incentive which places the burden on the final users of the data/ratings.

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

☐ Yes

☒ No

☐ Don't know / no opinion / not applicable

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

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Pricing approaches are often inconsistent. The level of detail provided does not always allow a full understanding of the pricing components. Moreover, this does not always allow for comparability.

III. QUESTIONS ON THE NEED FOR EU INTERVENTION

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

☐ Don't know / no opinion / not applicable

Please explain why:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

As mentioned above, the processes and methodologies used by rating agencies should be transparent. This should also address the needs of retail investors that pay close attention to ESG ratings and may base their investment decisions on them. All in all, it should be transparent to investors what ESG ratings and their measures entail, how they are being carried out, based on which data and as how reliable the data used can be considered.

Rating providers should disclose, in short, the methodology for their rating approach (as required under SFDR draft RTS for Financial Market Participants) and its limitations as well as the methodology for their normalisation approach to rating scales to highlight possible bias in the ratings.

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
☐ Don't know / no opinion / not applicable

Please explain your answer:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

As highlighted above, the implementation of a code of good practice for ESG rating providers should be considered. This should be conceived as a soft law tool or guidance which shall foster the required transparency from a user perspective within this activity.

Together with such a code, it is also important to have an enforcement system such as an independent oversight committee (involving users of ESG ratings) to ensure the enforcement of a transparent and robust regime in terms of methodology and underlying data.

In general, we stress out that the right tools should be in place to improve the functioning of the market without jeopardizing the diversity of choice for investors. As long as there is clarity and transparency in them, investors value having different perspectives in terms of methodology and analysis,

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

Please select as many answers as you like

☒ 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 the other elements the intervention should focus on and explain what solutions and options you would consider appropriate:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

A further major issue that goes beyond the question of ESG ratings is the lack of and the discrepancies between the transparency shown by data vendors regarding how they develop their findings on taxonomy alignment based on certain raw data.

Rating agencies very often compensate for the lack of ESG data points disclosed by issuers by using estimates based on peer or sectoral data to rate companies. Such approaches may result in increased greenwashing risk and could lead some issuers to adopt strategies to publish (or withhold) information in a way that is to their advantage.

This is a vicious circle because rating agencies are faced with potential clients from the financial world - under pressure to provide various reports - for whom the coverage rate is a determining factor in the choice of a provider, which encourages them to use estimates.

The rather inelastic demand for ESG data created by regulation also gives pricing power to ESG data providers. Consequently, another area that we would suggest regulators to currently pay attention to is the concentration and price competition in the market.

However, as financial markets thrive on information, the availability of new and cleaner data from issuers may facilitate price discovery over time. It could possibly eventually also help to mitigate systemic market risk.

Please explain what solutions and options you would consider appropriate in order to improve transparency on the operations of the providers:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

It should be transparent to investors: what ESG ratings and their measures entail; how they are being calculated - based on which data; and as how reliable the data used can be considered.

In general, we believe that the right tools to improve transparency should be in place without jeopardizing the diversity of choice for investors.

Please explain what solutions and options you would consider appropriate in order to improve transparency on the methodology used by the providers:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

As mentioned above, rating providers should disclose, in short, the methodology for their rating approach (as required under SFDR draft RTS for Financial Market Participants) and its limitations as well as the methodology for their normalisation approach to rating scales to highlight possible bias in the ratings.

A code of good practice for ESG rating providers should be considered to be implemented, as a soft law tool or guidance which shall foster the required transparency from a user perspective within this activity. It is also important to have an enforcement system e.g. an independent oversight committee (involving users of ESG ratings) ensuring the enforcement of a transparent and robust regime in terms of methodology and underlying data.

In general, we would like to stress that the right tools to increase transparency should be in place without jeopardizing the diversity of choice for investors. It is important to have different perspectives in terms of methodology and analysis, as long as there is clarity and transparency in them.

Please explain what solutions and options you would consider appropriate in order to improve the reliability and comparability of ratings:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Please explain what solutions and options you would consider appropriate in order to clarify what is meant by and captured by ESG ratings, to differentiate from other tools and services:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

We believe the current definitions of ESG ratings does not per se constitute an issue for the market (as indicated under the second question of section II - FUNCTIONING OF THE ESG RATINGS MARKET. However, we believe that improved transparency, as mentioned above, would promote a better understanding of what is captured under ESG ratings

Please explain what solutions and options you would consider appropriate in order to clarify objectives of different types of ESG ratings:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Please explain what solutions and options you would consider appropriate in order to improve transparency on the fees charged by the providers:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Please explain what solutions and options you would consider appropriate in order to avoid potential conflicts of interests:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Please explain what solutions and options you would consider appropriate in order to provide some supervision on the operations of these providers:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

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

☐ Don’t know / no opinion / not applicable

Please explain why:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

We would like to refer to the suggested solution of a code of conduct and independent oversight committee in order to ensure transparency. We would also like to highlight that if any form of regulation or supervision were to be considered, it would be crucial to ensure that this does not constitute a barrier for the entrance of new EU and non-EU 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 to global or non-EU investors?

☐ Yes

☒ No

☐ Don't know / no opinion / not applicable

Please explain why:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

We would like to refer to our response above.

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

☒ Yes

☐ No

☐ Don't know / no opinion / not applicable

Please explain why:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Rating providers should disclose the methodology for their rating approach (as required under the SFDR draft RTS for Financial Market Participants). Moreover, we believe these disclosure requirements should also reflect the limitations and the methodology used to normalise their approach to rating scales in order to highlight possible biases in the ratings.

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

☐ Yes

☐ No

☒ Don't know / no opinion / not applicable

Please explain your answer:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Whilst we would welcome the use of a template to describe the use of the methodologies, this should not lead to a standardization of the methodologies used by the providers.

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

☐ Don’t know / no opinion / not applicable

Please explain your answer:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

As mentioned above, we would suggest taking a soft law approach to ensure transparency. In this context, we are of the opinion that transparency should be ensured independent of the size of the provider.

In addition, it is very important that if any regulation/potential supervision was to be considered, this should not constitute a barrier for new entrants, independently of whether these are EU or non-EU providers.

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

☐ Percentage of EU companies/financial products rated (in the case of providers located outside the EU and not providing services to EU investors but rating EU companies/financial instruments)

☐ Other metric(s)

☐ Don’t know / no opinion / not applicable

Please specify to what other metric(s) you refer and explain:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

Please explain your answer:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

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

☐ Don't know / no opinion / not applicable

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)

Don't know / no opinion / not applicable

Please specify to what other metric(s) you refer and explain:

5000 character(s) maximum

including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

b) Costs of an EU intervention

(N/A)