

Response to the European Commission consultation on the proposal for regulation on the transparency and integrity of ESG rating activities

To: European Commission
From: The Dutch Fund and Asset Management Association (DUFAS)

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Subject: **EC consultation on ESG rating providers regulation**
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The Dutch Fund and Asset Management Association (DUFAS) welcomes the opportunity to respond to the public consultation on the proposal for regulation on the transparency and integrity of Environmental, Social and Governance (ESG) rating activities, as published by the European Commission on 15 June 2023.

Introduction

DUFAS and its members welcomes the proposal for regulation on the transparency and integrity of ESG rating activities. ESG ratings and ESG data are important for asset managers. Asset managers are (i) users of ESG ratings and data, (ii) their financial products are subject to ESG ratings, and (iii) asset managers may also produce internal ESG ratings themselves. With these roles in mind, we have read and considered the European Commission proposal.

We welcome more transparency, comparability and scrutiny on fees of ESG ratings

DUFAS and its members emphasize therefore the need for a well-functioning ESG ratings market that provides relevant, reliable, and comparable ESG ratings. We support requiring transparency on methodologies, the purpose of the ratings such as performance work-based or outcome-based also in the name of ratings, the use of underlying data sources, and any engagement with rated entities. We also suggest requiring ESG ratings providers to offer rated entities the opportunity to identify potential mistakes in the rating for correction.

Concerns about the compliance costs and availability of ESG rating and data

However, it is important that compliance costs remain low in order to make sure that ESG ratings are affordable and available for a competitive market price for European asset managers, in particular for mid to small managers. Hence, a too stringent authorization regime for ESG rating providers may lead to an increase of compliance costs, also possibly caused by a reduction of competitiveness in the EU market for ESG rating providers. Especially for non-commercial ESG ratings providers and ESG data providers, the compliance costs are likely to be too high to be able to continue their operations. On the other hand, the ESG ratings published by the respective non-commercial parties are valued by the market. To prevent the ratings to disappear, we therefore suggest considering to exclude non-commercial ESG ratings providers and ESG data providers from the proposal.

In addition, we do think ESG raters should remain independent, although conducting ancillary activities by such firms should not be subject to too stringent prohibitions, as long as there are sufficient conflict of interest arrangements are in place. For example, ESG rating agencies should be allowed to combine these activities with that as data provider.

We therefore are hesitant whether a full authorization regime for ESG rating providers is the appropriate way forward. Where the main goal should be transparency in reliability, accurateness and comparability of ESG ratings, the question arises why the European Commission has opted for a full authorization scheme and finds this necessary to achieve this goal rather than an industry code of conduct (Option 1) or a registration and light supervision (Option 2) as described in her proposal (see page 7). Both Option 1 and Option 2 may also be sufficient to reach the goal of improving transparency in reliability, accurateness and comparability of ESG ratings.

Regulation of ESG ratings providers must be consistent globally

DUFAS members operate and serve clients globally. To create a level playing field, the regulation of ESG ratings providers must be consistent with jurisdictions outside of the EU. This would reduce the risk that third country ESG ratings providers would exit the EU market resulting in differences in the quality provided to non-European and European clients. Here again, where the EC proposes a full authorization scheme, it is essential that this does not hamper the availability of widely used ESG rating providers. Moreover, where it is foreseeable that ESG rating providers may refrain from opting for a license to operate in the EU market, a proper equivalence decision pursuant to draft article 9 of the proposal should be in place to ensure continuance of ESG ratings into the EU market.

Separate code of conduct for ESG data vendors desirable

The use of ESG data and data products is growing in importance and asset managers face similar issues related to transparency. However, we believe that an effective implementation of the European Single Access Point (ESAP) would sufficiently cover such issues for ESG data. A similar treatment as ESG ratings, such as a full authorization scheme, would be inappropriate as it would raise the barrier for crucial innovation and new entrants in the ESG data products market.

However, we are supportive of the application of certain transparency rules to data vendors similar to ESG rating providers. For financial market participants, it is essential that ESG data vendors are transparent about their fees, the source of the data and potential methodologies used. Data on companies may be derived from and based on (i) public information sources, (ii) non-public sources, but obtained directly from the companies via bilateral discussions and interviews, and (iii) estimates by the ESG data provider itself. In the latter case, transparency should also be given as to the methodology used which is the basis of the provision of such estimates. Again, these transparency rules could be prescribed by means of a code of conduct scheme. They do not have to be embedded via a full authorization scheme.

We therefore propose to include *"the provision of raw ESG data that do not contain an element of rating or scoring, and is not subject to any modelling or analysis resulting in the development of an ESG rating"*, as defined in draft article 2 (2)(c), into the scope of the Draft Regulation, but only limited to the transparency requirements under Chapter 2 of the Draft Regulation. Furthermore, where ESG data vendors use estimated data, the Draft Regulation should make clear if and when such estimates could entail an opinion or could be considered to constitute an ESG rating within the meaning of the Draft Regulation or not.

Internal ratings produced by asset managers

As said asset managers also produce internal ESG ratings for various purposes. We welcome article 2(2)(b) of the Draft Regulation that provides that '*ESG ratings produced by regulated financial undertakings in the Union that are used for internal purposes or for providing in-house financial services and products*', are exempted from the Draft Regulation. However, we believe that this exemption should be clarified. It needs to be clear that asset managers or any other financial undertaking for that matter should be allowed to share and publish their internal ratings. For example, under the SFDR, asset managers need to publish in their precontractual, periodic, and website information on financial products, more in particular the sustainable investment percentage. These sustainable investment percentage may currently be based on each asset manager own methodology and assessment, and by publishing such information publicly this may not be considered to be 'in-house' only. Hence, in order to avoid that ratings and assessments produced by asset managers fall under the Draft Regulation, we propose to clarify to exclude from the scope of the regulation any rating that could be provided by financial market participants as they are already may be covered by other pieces of regulation.

Investment research

Finally, investment research providers may also include ESG related opinions or qualifications on companies as part of their investment research report. The question arises whether such opinions or qualifications will also fall within the scope of this Draft Regulation. Here again, if the Draft Regulation may be applicable to research providers as well, it has to be avoided that the possible costs of compliance as a result hereof should not impede the availability of investment research in the financial markets.

DUFAS: Dutch Fund and Asset Management Association

Since 2003, DUFAS has been committed to a healthy asset management sector in the Netherlands. DUFAS has more than 50 members: from large asset managers who invest Dutch pension and insurance assets to smaller, specialist asset managers. DUFAS increases awareness of the social relevance of investing, helps to develop sector standards and represents the sector in the implementation of new laws and regulations. In addition, DUFAS is committed to a single European market with equal regulations.

More information

Would you like to respond, or should you have any questions? I would be pleased to hear from you. Please feel welcome to e-mail Randy Pattiselanno, DUFAS manager strategy & regulatory affairs, at rp@dufas.nl.