Eurosif

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Subject: ESG Ratings and their role in the market for sustainable investment products

Dear Ms. Cazenave,

I am writing to you on behalf of Eurosif, the European Sustainable Investment Forum, to express our appreciation for the recently published ESMA Sustainable Finance Roadmap 2022-2024 and to comment on the Call for Evidence in relation to ESG ratings. We are encouraged by ESMA's strong commitment to monitor the use of ESG ratings in capital markets and in sustainable investment products and address potential risks of greenwashing as the industry adapts to the application of new regulatory requirements such as SFDR, the Taxonomy and the EU Climate Benchmarks.

Support for a targeted and proportionate regulatory intervention on ESG ratings

ESG ratings play an increasingly important role in European capital markets, as a growing number of investment products and strategies may integrate these ratings in their investment process. These ratings are meant to express a view or opinion of a specific provider accross a complex and wide range of Environmental, Social and Governance (ESG) issues. Given their nature, the methodologies applied will inevitably vary between providers and the ratings for a company may vary and display low correlation.

We believe this very pluarlity of views is beneficial for investors and enables them to form a more sophisticated view of a particular company, using different ratings to assess different aspects of the Environmental, Social & Governance specturm. We find the analogy made with credit ratings and their high degree of correlation to be inappropriate. We would rather compare ESG ratings to buy/hold/sell recommendations from sell-side analysts, where a plurality of views is essential to the functioning of the market, for investors with different objectives and time-horizons.

Therefore, for investors it is vital to understand transparently how ESG Ratings are generated and the quality and type of data they are built on. Therefore, any regulation should focus on; (i) transparency of methodologies and data sources, particularly whether the data has been reported by companies, is obtained from alternative sources, or based on proprietary estimates, (ii) mitigation of potential conflicts of interest, and (iii) a possible distinction between ratings seeking to capture exposure of a company to ESG risks, versus ratings seeking to capture sustainability impact (whether financial or otherwise). The key will be to ensure regulation remains proportionate, and that the scope of the regulation does not restrict innovation in data solutions.

We would caution against a regulatory intervention that would require investors to rely exclusively on ESG ratings and data solutions that are regulated.

Finally, we would like to underline the importance of reliable, decision-useful corporate disclosures that will allow data vendors to provide better ESG data to investors.

ESG ratings are highly relevant for SFDR products.

ESG ratings are directly relevant for the application of the SFDR. A growing number of financial products in scope of the SFDR; (i) promoting environmental and/or social characteristics (so-called Article 8 prodcuts) or, (ii) pursuing sustainable investment as their objective (so-called Artile 9 products) are using ESG ratings for various purposes. Some Article 8 products employ ESG ratings to substantiate claims as to, or to convey the existence of, enviornmental or social characteristics. In the case of Article 9 products, ESG ratings may be used to identify companies and their securities that would be elibigle as sustainable investment as defined by Article 2(17). Both types of products may also be using ESG benchmarks that may be constructed on the basis of the ESG ratings of constituents. Therefore, more transparency on ratings' methodologies, objectives and sourcing of data is important to ensure a more effective application of SFDR.

The merits of the debate on the harmonisation of methodologies will require a granular assessment of the ESG ratings and other data services

As with previous regulatory frameworks seeking to regulate data services, a debate is likely to emerge on the merits of further harmonising the methodologies underpinning ESG ratings. These discussions are driven often by a desire to ensure comparability of data outputs for market participants.

As mentioned earlier, ESG ratings can provide a plurality of views that may be helpful to markets. They will seek to provide a view across a broad spectrum of ESG matters and as a result are never likely to be fully harmonised. Seeking the harmonisation of methodologies would effectively create a uniformity of market views which may not necessarily be a desirable, nor feasible, outcome and may lead, inadvertently, to the misallocation of capital.

Comparability however is an essential condition for part of the EU sustainable finance regulatory framework to function properly. Investors will need to have confidence that they can rely on accurate comparisons between different companies and financial products' level of Taxonomy-alignment, the proportion of sustainable investments as well as the measurement of Principal Adverse Impacts (PAIs) to make informed investment decisions under SFDR and the Taxonomy. Therefore, it may be necessary to enhance comparability of data points under these regulations through more granular and harmonised methodologies there.

To conclude, we believe it is essential for any further regulatory intervention in the area of ESG ratings, data and services to appreciate the diversity of data solutions offered, the purpose they each serve and whether it is desirable or feasible to seek further harmonisation of methodologies. The conclusions may be different per type of data service. This nuance will be vital to crafting appropriate policy responses to the dynamic and multifaceted market in ESG data services in the EU.

Thank you for your consideration of this important issue.

Yours sincerely,

Victor van Hoorn
Executive Director

C.C. Mr. John Berrigan, Director General, DG FISMA

Ms. Katherine Power, Policy Coordinator, Cabinet of Commissioner Mairead McGuinness

About Eurosif

Eurosif is the leading pan-European sustainable and responsible investment (SRI) membership organisation. Based in Brussels, its mission is to promote sustainability through European financial markets. Eurosif works as a partnership of Europe-based national Sustainable Investment Fora (SIFs) with the direct support of their network which spans over 400 Europe-based organisations drawn from the sustainable investment industry value chain. These organisations include institutional investors, asset managers, financial services, index providers and ESG research and analysis firms totalling over €20 trillion in total assets. Eurosif' s main mission is of a general interest as it represents a multistakeholder vision of sustainable investment, supported by philanthropic foundations. Eurosif works on public policy, research and creating platforms to foster best practices in sustainable investment.