Eurosif response to the EU Commission's consultation on the functioning of the ESG ratings market in the European Union and on the consideration of ESG factors in credit ratings

INTRODUCTION
Eurosif is the leading pan-European association promoting sustainable finance at European level - encompassing the European Union (EU), the wider European Economic Area (EEA) and the United Kingdom (UK). In addition, Eurosif supports initiatives at global level to promote an ambitious agenda for sustainable finance. Eurosif is a partnership comprised of Europe-based national Sustainable Investment Fora (SIFs). Each of the SIFs has a broad and diverse membership including asset managers, institutional investors, index providers and ESG research & analytics providers with aggregate assets under management (AuM) amounting to over EUR 20 trillion. Eurosif's activities involve contributing substantively to public policy and conducting research that enables a better understanding of ESG and SRI markets and the obstacles encountered by sustainability-oriented investors. Eurosif and its members are committed to the growth and development of sustainable finance and support the ambition of global and European policymakers in enabling a fully transparent and reliable sustainable investment market through appropriate and well-designed regulation and industry practice. Eurosif appreciates the opportunity to respond to EU Commission's consultation on the functioning of the ESG ratings market in the European Union and on the consideration of ESG factors in credit ratings. We welcome the initiative undertaken by the EU Commission to launch a legislative action aimed at introducing transparency requirements in respect to data collection, methodology, and conflicts of interest.

PART A – ESG RATINGS

I - Use of ESG ratings and dynamics of the market

Questions for investors, asset managers and benchmark administrators	
Q1: Do you use ESG ratings?	
Yes, very much	X

Yes, a little	
No	

At this juncture, the market of ESG ratings & data is an essential component of the sustainable finance industry, as it equips investors with the information they need to define the objectives of their investments, to implement their strategies, and to comply with EU transparency rules such as the Sustainable Finance Disclosure Regulation (SFDR), the Taxonomy-alignment of investment products, and the EU Paris-aligned and Climate Transition Benchmarks Regulation (EU PAB / EU CTB).

ESG ratings & data products are even more important for investors, as information publicly reported by investee companies is still inadequate. Moreover, as long as investment strategies become increasingly diversified and sophisticated in terms of focus, objectives, and approaches, ESG analysis & research is constantly improving and innovating to support this growth and meet the evolving demand of investors.

Specifically, ESG ratings are meant to support investors: 1) in the **identification of financially material ESG risks** at security or portfolio level; 2) in achieving **portfolio construction objectives** (e.g. screening and selection of best-effort/best-in-class companies; impact); 3) in the identification of companies to target with **engagement initiatives**.

Q2: 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	X
ESG ratings providing an opinion on the compliance of companies with frameworks and rules	X
Exposure to and management of ESG risks	X
ESG ratings providing an opinion on a company performance towards certain objectives	X
ESG ratings providing an opinion on the impact of companies on the society and environment	X
ESG ratings providing an opinion on the ESG profile of the company	X
Other	X
If you responded that you use "other" ESG ratings providing an opinion on companies, please specify to what "other" ESG ratings you refer:	

*(Comment to the option "*ESG ratings providing an opinion on the impact of companies on the society and environment*")* – Most of the ESG ratings currently offered express evaluations on the **exposure of companies to ESG-related risks** and on their capacity to manage those risks.

Only few have started to pivot towards measuring impacts in the spirit of a double materiality approach.

We are seeing regularly confusion in the market whereby ESG considerations or ratings are automatically equated with a clear and evident contribution toward addressing sustainability issues. For instance, quite a few investment products use ESG ratings focussing on risks as a core element of the integration of ESG factors into their investment process, while claiming to be aimed at contributing towards achieving certain sustainability objectives. However, in most case this causality between ESG risks considerations and real-world impacts is hard to substantiate.

Q3: ESG ratings providing an opinion on:	
Investment funds	X
Other financial products	X
If you responded that you use ESG ratings providing an opinion on investment funds, which type of ESG ratings do you use (non-exhaustive list - multiple answers possible):	
Exposure to and management of ESG risks	X
Impact on the society and environment	X
ESG characteristics	X
Other specialised ratings	

Q4: To what degree do you use ESG ratings in investment or other financing decisions on a scale of from 1 to 10 (1- very little; 10 - decisive)?

Rate: 5

Investors generally use ESG ratings as: 1) **monitoring tools** for their portfolios; 2) constituents of the **evaluation process** of investee entities (often among other tools); 3) **drivers of investment decisions** (often among other tools); 4) reference for **engagement & voting decisions**.

The wide heterogeneity in the characteristics of investors, and the types and sophistication of the investment strategies, generates very diverse outcomes in the relevance of ESG ratings in investment decisions.

- First, the relevance of ESG ratings differs significantly depending on the **characteristics of the investor** – in particular, on the **resources** allocated to sustainable investments, and/or on the **experience** in using ESG ratings, analysis & research tools.
    - **Operators with more resources available, and/or longer experience in sustainable investing tend to rely on proprietary evaluation methodologies, and to consider third-party ESG ratings as one input (among others) in the decision-**

making process. In some cases, these operators buy different types of ESG ratings from multiple providers and integrate each one in a different investment strategy (or, in different steps of an individual investment strategy) according to the specific focus, objective or methodological approach of the rating. In some cases, these operators adopt proprietary methodologies to aggregate ESG ratings from different providers and to mix them with internal research in order to produce a final evaluation of the company. Eurosif also collected anecdotal evidences that most operators tend to increasingly buy ESG data on performance measurements (e.g. on GHG emissions, carbon efficiency, etc.), which are in turn assessed, analysed, and compared using proprietary research and analysis.

    - On the other hand, **investment firms with limited resources available to sustainable investing have less potential to develop their own evaluation methodologies**, and many operators are in the process of developing internal expertise in using ESG data & research tools. Quite often, these operators might rely more on the assessment of third-party ESG ratings, rather than process data on performance measurements. Moreover, it is more likely they use the services of one single external provider, rather than buying different products from multiple providers. In these cases, **the role and relevance of ESG ratings in the overall investment decision tend to be more significant** – of course, depending on the type of the investment strategy adopted.

- The role and the relevance of ESG ratings can also depend on the **type, the structure and the sophistication of the investment strategy**. ESG ratings can play a prominent role in some categories of sustainable investment strategies. For instance, best-in-class strategies can screen companies based on their ESG ratings. In some cases, however, the relevance of ESG ratings in the overall investment decision might be limited, as investors tend to mix different investment strategies in the same portfolio, and each strategy may cover just a portion of the assets under management. For instance, ESG ratings can be used in individual steps of the evaluation process, e.g. to screen companies based on their risk profiles on certain ESG topics. As described above, the level of sophistication of the investment strategy of each operator determines how and to what extent ESG ratings are integrated in the investment process.
  Additionally, ESG ratings may play a prominent role in **passive strategies**, where ESG ratings can play an important role in the construction of ESG benchmarks.

Multiples cases have been reported to Eurosif according to which **the use of ESG ratings by asset managers is influenced by the mandate received from their clients, i.e. the asset owners**.

- For instance, asset owners may require asset managers to use the ESG ratings of a specific third-party provider (in general, the one that they are also using, or for which they have a preference), because they are interested in comparing the outcomes of the asset managers' internal evaluations of the investee companies with the assessments of that provider.

- In other cases, asset owners may ask asset managers to define the investment universe of the funds by using ESG ratings on specific topics (e.g. by setting thresholds based on a certain level of grade).

Q5: If you don't use ESG ratings, or use them to a very small degree, what do you use in your investment or other financing decisions?

Eurosif has been explained by multiple users of ESG ratings that, after analysing the final assessments of multiple companies as well as monitoring the frequency of the data review, they have the impression that some ESG ratings methodologies might in some instances favour larger companies, as they have more resources to implement well-structured policies and file more complete sustainability reporting. This is often because they are subject to legal obligations or market pressure to provide some sustainability reporting whereas smaller companies may not be in a similar situation. Another factor with similar implications is whether a particular company is located in a jurisdiction mandating sustainability reporting or not.

Hence, some of these users tend to complete the assessment with **in-house research**, or by **seeking direct contact with the investee companies**. In other cases, users develop **proprietary methodologies** to make their own evaluation of the companies' sustainability performances **by processing raw data** (i.e. data publicly disclosed by companies) and **third-party ESG data products**. Many of these practitioners are of the opinion that the market is gradually pivoting towards this type of approach, of course according to the resources available and the investment approach of different investors.

Beyond ESG ratings, investors are using a range of other tools and metrics made available by data providers:

- climate scenario and net-zero alignment methodologies;
- data for quantitative risk management;
- improvement scores;
- impact measures like revenues impacting environmental and/or social objectives (i.e. alignment with EU Taxonomy);
- exclusion lists, including for example controversial weapons screening or product involvement screens.

Q6: Do you use overall ESG ratings or ratings of individual Environmental, Social or Governance factors?	
Overall ESG ratings	X
Ratings of an individual Environmental, Social and Governance factors	X
Ratings of specific elements within the Environmental, Social and Governance factors	X
Other types	
Don't know / no opinion / not applicable	

In general, investors appreciate that the distinctive trait of ESG ratings is the aggregation of multiple topics put in certain contexts, and/or the adoption of different approaches to evaluate the same aspects. **The key value of using ESG ratings lies in the analysis of the evaluation process, and not necessarily (or, at least, not only) in the final assessment.**

Therefore, users tend to choose the type of ESG ratings they consider fit for their investment strategy, and more suitable to help them achieve their investment objectives. **The focus on the overall spectrum of ESG topics, on one specific factor, or on a specific element within a factor very much depends on what the user intends to assess, and how.**

As regards the use of "overall ESG ratings", **what is essential for users is to access adequate information** on the underlying methodologies and the constituent of each assessment. More precisely, users are interested in understanding: 1) how each ESG factor is assessed; 2) how each ESG factor is weighted as compared to the others; and 3) how the weights of each ESG factor are determined, for example depending on how material they might be for the specific industry in which the company operates.

In most of the software platforms allowing access to ESG ratings users can easily access general as well as very detailed information about which environmental, social and governance dimensions are assessed based on which indicators. Where there might sometimes be a need for more transparency or explanation is how the factors are in the end weighted or how the indicators existing lead to a specific outcome or evaluation.

Q7: Do you buy ESG ratings as a part of a larger package of services?	
Yes	X
No	
Don't know, no opinion, not applicable	
If you responded "yes" to the previous question, what other services do you buy?	

Here below a list of the services that are normally bought, according to asset managers inquired by Eurosif:

- ESG **data sets on companies' performance measurements,** with particular interest for the data points required to comply with the EU regulations (i.e. data on Taxonomy-alignment and the Principal Adverse Impact Indicators (PAIIs) under the SFDR);
- **forward-looking indicators, especially on climate** (e.g. climate scenario analysis, Implied Temperature Rise Indicators, net-zero alignment methodologies);
- other **ESG evaluations** (e.g. impact and business involvement evaluations);
- **analytics and management tools** (e.g. portfolio monitoring, portfolio alignment tools to climate targets).

Usually, we understand that ESG ratings are bought on a standalone basis but that users often can purchase a large range of services from the same providers.

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?**

[See Q33]

Q8: What are you using ESG ratings for? (multiple choice)	
As a starting point for internal analysis	X
As one of many sources of information that influence the investment decisions	X
To meet regulatory or reporting requirements	X
As a decisive input into an investment decision	X
As a reference in financial contracts and collaterals	
For risk management purposes	X
Other(s)	X

If you use ESG ratings for other purposes, please specify which ones?

- Eurosif has heard of multiple instances whereby investors (often those with more sophisticated investment strategies) buy ESG ratings with the objective to **access the underlying data and research**, rather than directly integrate the outcomes of the assessments in investment strategies.
- Some investors use ESG ratings to **compare** and analyse them with the result of the evaluations obtained via **proprietary methodologies** (asset manager are often required to do so by their clients).
- ESG ratings (especially climate-related ratings) can be used to identify sustainability related issues and controversies and **set engagement objectives** with investee companies.

Q9: As a benchmark administrator, how do you take into account ESG ratings for the <u>construction of a benchmark</u> and/or in disclosures around a benchmark?
ESG ratings can play a relevant role in passive investments, as many index-based strategies may rely on rules, thresholds and goals based on ESG ratings. For instance, benchmark providers often build their sustainability benchmarks based on the ESG ratings of the constituent companies.

Q10: Do you refer to ESG ratings in any <u>public documents or materials</u>?	
Yes	X
No	
If you responded "yes" to the previous question, specify the type of documents of materials	
Investment funds can refer to ESG ratings to justify their sustainability credentials, to describe their investment strategies, and to explain their investment objective according to the requirements set in Article 8 and Article 9 of the SFDR, and further detailed in the respective Delegated Regulation. In that case, information on the use of ESG rating and other data products must be disclosed on the website of the financial market participants, and in the pre-contractual documents and in the periodic reporting of each product. Investment funds may disclose the ESG ratings that they use in their investment strategy as part of their submissions to obtain the national labels for sustainable products.	

Q11: <u>What do you value and need most in ESG ratings</u>? (please, select as many answers as you like)	
Transparency in data sourcing and methodologies	X
Timeliness, accuracy, and reliability of ESG ratings	X
Final score of individual factors	X
Aggregated score of all factors	X
Rating report explaining the final score or aggregated score	X
Specific information (Please explain – comment box here below)	
Data accompanying rating	X
Other aspects	
Please explain your answer:	
What asset managers tend to find useful in ESG ratings is the fact that they **aggregate different data points and evaluate them by taking into account the background and context** in which the company operates, according to a specific methodology (e.g. industry, characteristics of	

operations, regulatory environment, sustainability policies of the countries where it operates, etc.)

Additionally, investors (especially the most advanced in sustainable investing and/or with more resources allocated to ESG analysis) are developing a growing tendency to: 1) analyse and assess the outcomes of ESG ratings through in-house research and analysis, often comparing the results between different providers and/or with their own outcomes; and to 2) buy ESG ratings to access the underlying data & research, rather than directly integrating the final scores in the investment decision.

Therefore, alongside coverage, what is relevant for users is to **access reliable and accurate information on the data and the methodologies underpinning the ESG ratings**.

Q12: To what degree do 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)?

Rate: 5

If we consider the whole spectrum of ESG ratings & data products, in recent years **the market went through a consolidation wave,** with a number of ESG ratings providers being acquired by broader data services. In parallel, **the demand for ESG ratings & data products has dramatically increased**, as a consequence of a rise of the appetite for sustainable investments, as well as for the introduction of regulatory requirements on transparency in the EU (e.g. SFDR & Taxonomy) and in other jurisdictions.

In the European markets, in particular, financial market participants tend to revert to third-party providers to obtain the data necessary to comply with the regulations. This is both because it is a more efficient way of gathering data for a portfolio and because many investee companies do not yet report specific data required by regulations such as SFDR and the Taxonomy Regulation. In these cases, the offer available on the market may still be limited, as providers are themselves developing the expertise and the resources to address the new information needs – especially because reliable and accurate reported information is not consistently available, and therefore need to be often estimated. However, we acknowledge the fast-growing pace at which providers are introducing new services.

As regards ESG ratings, in particular, a difference can be identified between the **mature segments** which are mainly dedicated to ESG ratings focussed on assessing sustainability risks and opportunities – and the **new segments mostly focused on innovation**, which are attracting new entrants and therefore will see more players focusing on niche markets, at least at the first stages.

These dynamics, together with the increasing sophistication of the investment strategies, have triggered a **tight competition among providers**, which are constantly encouraged to quickly **improve the coverage of their products**, both in terms of number of the companies rated and on topics/regulations covered. The competition also incentivises the **improvement of the quality, the specialisation, and the innovation of the methodologies**. As far as **costs** are concerned, **users overall report seeing the total costs for ESG ratings & data products having increased significantly over the last couple of years**. In some cases, this is due to the augmented volume of services and products used. In other cases, the increase of the price of single ESG ratings & data products may be motivated by the necessity of the data providers to expand their capabilities with the aim of improving coverage and quality of the services offered. On the other hand, some users have reported some cases of increased prices for similar data services offerings without clear explanation for these increases. In general, users have often made the point that the **structure of fees and pricing** of ESG ratings & data services **are not always clear** and may sometimes vary significantly depending on multiple aspects, including in which category the user may find itself (asset manager, asset owner, bank).

[...]

Questions for all respondents	
Q18: Do you consider that the market of ESG ratings will continue to grow?	
Yes	X
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 (not at all) to 10 (very much)?	
Growth in demand from investors in ratings of companies for their investment decisions	7
Growth in demand from companies in ratings including on rating future strategies	7
Further standardisation of information disclosed by companies and other market participants	4
Other	5
If you responded “other” to the previous question, please specify the other reasons you see for this market to continue to grow:	
It is highly reasonable to expect the overall market of sustainability-related ratings, research & data products will continue to grow significantly in the foreseeable future, in parallel with the ever-increasing centrality and sophistication of sustainable investments, and the establishment of a rigorous transparency regulatory framework in the EU. Hence, the growth may	

be driven by regulatory requirements as well as commercial reasons, as new investment strategies will require new analysis & research tools on new topics.

Despite the fact that corporate reporting is expected to grow in terms of coverage and quality, the demand for ESG data & ratings products may continue to grow in the foreseeable future, because they propose a more efficient way to gather information from individual companies, especially for users that have less resources available. Within this trend, the wide heterogeneity of the market in terms of sophistication of the investment strategies & the characteristics of investors generates **very diverse dynamics in the demand for ESG ratings**. In particular:

- We would expect that from some asset manager with more sophisticated investments strategies, the demand for ESG raw data and ESG data products would grow more significantly than the demand for ESG ratings. In other words, the interest seems to be gradually **shifting from "opinions" (i.e. ratings) towards "performance measurements" (i.e. raw data and ESG data products)**. For instance, from conversations with practitioners Eurosif understands a practice of some users is to buy ESG ratings with the objective to access the underlying data & research, rather than directly use the outcomes of the assessments in the investment strategies.
- Having said that, ESG ratings might continue to play a prominent role in some investment strategies such as passive index-based strategies which are growing in the ESG and responsible investment space. Some asset managers have proprietary methodologies to produce evaluations based on an aggregation of third-party ESG ratings and internal research. For investors with less internal resources available to data analysis, **ESG ratings might continue playing an important role** in the adoption of the investment decisions. Finally, some **asset owners** ask their asset managers to use certain ESG ratings in the investment strategies of the funds.

Q19: Are you considering to use more ESG ratings in the future?	
Yes, to a large degree	
Yes, to some degree	X
No	
No opinion	
If you responded "yes" to the previous question, please explain why:	

The answer depends on the characteristics of the users and their investment strategy. [See answer to the previous question.]

In general terms, there is a growing tendency of the users to increase the granularity of the analysis and the complexity of the investment strategy. For some asset managers this may mean **diversifying the supply of ESG ratings** (e.g. users that rely on one ESG ratings provider have explained to Eurosif that they are planning to buy products from two or more providers).

Others have explained that they are planning to **use more performance measurements data** and form their own opinions.

Q20: Do you mostly use ESG ratings from bigger or smaller market players?	
Exclusively from large market players	
Mostly from larger market players	X
Mixed	
Mostly from smaller market players	
Exclusively from smaller market players	
Don't know / no opinion / not applicable	
If you use mostly or exclusively ratings from large ESG rating providers, what are the main reasons for this?	
Most users tend to prefer **larger providers** because their products have a **wider coverage** of rated entities. The assessments of larger providers may also have more significant capital market implications, as they have a wider base of financial markets operators that may make investment decisions based on those assessments. Therefore, investors that have the resources to buy ESG ratings from just one provider, tend to choose among the most well-established ones. **Smaller providers** tend to concentrate their offer on **highly-specialised and innovative products**, often focused on emerging trends, where there is a lack of data-driven knowledge (e.g. impact, biodiversity, etc.). Therefore, users with specific interests matching that offer will revert to those providers.	

Q21: Do you consider there is a sufficient offer of ESG ratings from providers located in the European Union?	
Yes	X
No	
No opinion	
If you responded "yes" to the previous question, please explain why.	
It seems that currently the majority of ESG ratings & data providers operating in the EU are part of large groups that are often headquartered outside the EU. However, we do not believe this constitutes a major problem as most providers have a significant presence in the EU. From our perspective, the guiding principle should be to focus on the quality of services offered and not where a provider might be located or headquartered. From our consultation with users and providers, several views exist amongst practitioners.	

Some users consider the location of the providers is irrelevant and focus mostly on the quality of the ESG ratings they can get. These users strongly oppose the creation of a system whereby providers willing to sell products in the EU are obliged to register and set certain operations in the EU, or whichever measure that would alter the natural dynamics of the market. Most of the established ESG ratings providers have a strong presence in the EU in terms of capabilities and expertise. Moreover, providers know best how to allocate their expertise and resources as they consider appropriate to increase coverage, quality and innovation of their products. This is particularly the case in attracting a sufficiently large pool of talented researchers and analysts. What is relevant in considering the reliability of the offer and the conduct of individual providers is: level of expertise; overall coverage; and the absence of biases. **Other users and some EU-based providers consider the prevalence in the market by non-EU companies as a topic of concern,** as they believe there are no sufficient safeguards to ensure that ESG ratings coming from non-EU providers are not negatively biased against the EU companies. Another point of concern that has been mentioned is the fact that, in general, north American and EU practitioners tend to have a very different perception of what sustainability means: for instance, the EU has embraced the double materiality approach (i.e. focus on risks & impacts), whereas the US is very much focused on financial materiality (i.e. concentrated on risk mitigation). On this last point, however, we would note that the establishment of a transparency framework whereby providers willing to sell products in the EU are required to clarify the objective and the methodologies of their ESG ratings, would allow users to understand whether the products fit their investment philosophy or not. Therefore, any misunderstanding in the approach adopted by different providers could be solved through transparency.

Q22: Finally, do you use <u>other types of ESG assessment tools</u> than ESG ratings (e.g. controversy screening, rankings, qualitative assessments, etc.)?	
Yes	X
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?	
Other tools that can be used by asset managers are: • ESG **data sets on companies' performance measurements,** with particular interest for the data points required to comply with the EU regulations (i.e. data on Taxonomy-alignment and the PAI indicators under the SFDR); • **forward-looking indicators, especially on climate** (e.g. climate scenario analysis, Implied Temperature Rise Indicators, net-zero alignment methodologies); • other **ESG evaluations** (e.g. impact and business involvement evaluation);	

• **analytics and management tools** (e.g. portfolio monitoring, portfolio alignment tools to climate targets). As regards **climate-related information**, the interest of investors is increasingly attracted by forward-looking metrics and indicators that describe the companies' targets and plans to decarbonise their operations and align with a climate neutral economy by 2050. Examples include: Implied Temperature Rise (ITR) indicators and other forward-looking indicators; scenario analysis tools, the adoption of third-party certified science-based net-zero targets (e.g. SBTi); the positioning in sectoral transition pathways (e.g. TPI); the participation in engagement initiatives (e.g. Climate Action 100+). Those tools are crucial for institutional investors that have set (or, that are willing to set) decarbonisation/net-zero targets in their investment portfolios.

Q23: Do you believe that due diligences carried out by users of ESG research are sufficient to ensure an acceptable level of quality?	
Yes	
No	X
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/EU1?	
Eurosif believes that **financial market participants are first and foremost responsible for the quality of the ESG ratings & data that they use in their investment products**. As ESG ratings & data products constitute an important part of the investment strategy, and allow its proper implementation, it is essential that investors and asset managers conduct a thorough due diligence of any data & research provider they may want to select, as well as adequate quality checks of the individual ESG ratings & data products that they may use in their investment strategies. Moreover, financial market participants should be transparent vis-à-vis their clients on ESG ratings & data products on which they rely to make ESG investment decisions. We have no indications at present that more regulatory requirements are needed to ensure a better due diligence. There are already requirements existing within the MiFID, UCITS and AIFMD frameworks.	

Q24: 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?
We would be cautious in using the term **comparability** when trying to assess the maturity and the understandability of ESG ratings, whose key quality is represented by the variety of approaches. ESG ratings have different objectives, focus on different topics within the ESG spectrum, chose different indicators and elements to grade companies on specific subjects, and

ultimately source and calculate data in a different way. As the final outcome of the judgment reflects all these differences, it is arguable whether "comparability" is what users would seek while using ESG ratings. We would rather observe that users might wish to evaluate a company's sustainability profile by considering two or more ratings with different methodologies – e.g. assessing risks or impacts; weighting different environmental and social indicators in different ways; normalising the final scores to the reference industry or to the overall universe, etc.).

Therefore, we underline the importance that users understand the characteristics of the ESG ratings, in order to be able to choose the products that are most suitable to their investment strategies, and that allow them to conduct an appropriate analysis on the investee companies according to their specific objectives. **The understandability of the ESG ratings depends equally on the transparency ensured by the providers on the one hand, and on the accuracy of the due diligence that is conducted by the users on the methodologies**, on the other hand.

In this regard, it should be noted that the **expectations and the needs of the users may vary significantly**.

- Users with significant resources, capacity, and expertise allocated to data analysis are able to scrutinise in details the ESG ratings and the final reports of each company assessed, and they often challenge providers on specific aspects of the methodology, or on individual data points. Based on several conversations with practitioners, Eurosif understands that **bilateral interactions between providers and users on specific cases are an essential part of the analysis**. For instance, asset managers often put in place mechanisms to detect potential discrepancies and revert to the provider to obtain explanations. Common questions of analysts may also focus on the materiality or weighting of specific factors in the calculation process. Eurosif has collected several anecdotal experiences of users not entirely satisfied with the explanations received from their providers: for instance, certain ESG ratings providers are reported to refuse to disclose certain information to their clients because the questions touch on commercially sensitive information about the methodologies (e.g. the most qualitative part of the assessment). These situations may undermine the capability of the users to fully understand the data.

- On the other hand, users with less resources available to process the ESG ratings' underlying data and indicators tend to rely more on the final outcomes of the evaluation process proposed by the providers. Hence, these users are interested in understanding more general aspects of the methodologies, such as the objectives (e.g. risks/impacts), the sustainability aspects that are assessed, the indicators chosen, the frequency of the data review, the approach towards estimates, etc. All these elements are generally disclosed by the providers in the documents outlining the methodologies.

In general, we often observe that in specific cases there is a **mismatch between the information disclosed by the providers** on the one hand, **and the needs/expectations of the users**, on the other hand. The methodologies are publicly disclosed, and explained in more granular details to the clients, often via bilateral exchanges. Still, some information needs/questions from users may remain unanswered. For instance, some providers do not disclose the underlying data of their ESG ratings; several providers disclose the sources of the information at the end of the overall company's analysis, rather than link each one to each respective indicator, as some users would prefer. When these situations occur, it may not be always feasible for users (especially those with less resources available) to switch and revert to a provider that they consider more transparent or reliable.

As regards the understandability of the products, it is also worth underlining that there are **frequent misconceptions on the objective of the ESG ratings**. Most of the currently available products evaluate the exposure of the companies towards sustainability risks, and this information is generally easily accessible to users. However, the same ratings are often incorporated into investments strategies that are meant to actively contribute to achieve certain sustainability objectives.

II - Functioning of the ESG ratings market

Questions for all respondents	
Q25: How do you consider that the market of ESG ratings is functioning today?	
Well	
Not well	X
Don't know / no opinion / not applicable	
Please explain.	

In order to function properly and serve the ever growing needs of investors, the market of ESG ratings has to ensure the greatest possible **coverage of rated entities, quality of the assessments, diversification of products, and innovation** – all in the most **cost-efficient way** as possible.

We want to underline a few general trends that deserve the attention of the EU policymakers, with a view to encouraging a more efficient functioning of the market.

- First, we consider important to **improve the quality and the fluidity of the flow of information between providers and users on the data sourcing and the methodologies** underpinning the ESG ratings. This is essential to allow investors to understand the meaning of the products they use in their investment decisions. This may require an **enhanced transparency by some provider**, as well as **more resources dedicated to the analysis of ESG data by some users**.

- **Investors' due diligence plays a central role** for a proper use of the ESG ratings in the investment process, and for providing accurate information to clients of the investment funds. To this end, it is important to **foster the adoption and improvement of appropriate market practices**, which may require (after adequate monitoring an evaluation by EU policymakers) to strengthen the supervision and/or to strengthen and further specify the requirements on investors' due diligence that are already set forth in the existing EU regulations.
- Several users have reported to Eurosif that in the market there is a low **transparency of the structure of the fees charged for each ESG product**, which may vary significantly depending on multiple aspects, including the type of clients. **Transparency on the structure of the fees** might be an area to be included in a potential upcoming EU regulation on ESG ratings.
- The reliability and quality of ESG ratings might be undermined by **conflicts of interest**, whose potential risks are inextricably entrenched in the business model of some providers. An upcoming EU regulation on ESG ratings might also introduce appropriate disclosure requirements to allow providers to demonstrate to the market how they intend to prevent and manage the rise of potential conflicts of interest.

The establishment of a **supervision system** may prove important to hold providers accountable for the information that they provide to users, including explanations on the methodologies adopted, the structure of the fees charged, and the treatment of the potential conflicts of interest.

A regulatory framework for ESG ratings providers will however not solve the underlying challenge which remains the accessibility of reported data by companies in the EU and outside the EU. That is why **the adoption of sustainability reporting frameworks within the EU and at international level remain of the utmost importance.** Only these frameworks will help to improve the quality of reported data which will conversely reduce the need for estimates.

Q26: 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	6
Lack of transparency on the methodologies used by the providers	7
Lack of clear explanation of what individual ESG ratings measure	4
Lack of common definition of ESG ratings	7
Variety of terminologies used for the same products	7
Lack of comparability between the products offered	5
Lack of reliability of the ratings	7

Potential conflicts of interests	6
Lack of supervision and enforcement over the functioning of this market	8
Other	

Q27: What do you think of the <u>quality</u> of the ratings offered on a scale from 1 (very poor) to 10 (very good)?
Rate: 6
Please explain why:

While the expertise on how to properly assess sustainability topics evolves, new tools are made available to financial operators, and more and more companies disclose more accurate data – **the market of ESG ratings is constantly improving its quality, innovation and diversification**.

Notwithstanding this general upward trend towards quality and sophistication, some cases have been reported to Eurosif whereby the users' trust in the quality of the products that are currently available might potentially result undermined. For instance:

- the assessments of **smaller companies** may be reviewed less frequently;
- the **granularity of the sub-sector classification** may be perceived as not completely adequate (e.g. some elements that are influential on the final assessment may turn out to be not relevant for a specific company considered);
- in some cases, users detect a **low correlation between the data on a company's performance measurement and the rating** assigned by the same provider to the same company on the same topic (e.g. looking at historical data, the performance improves, whereas the company is downgraded), and they are not able to understand the reasons behind the judgement of the provider, even after analysing carefully the methodologies;
- in some cases, users consider that the **data collection procedures** adopted by the providers are not adequate to ensure enough accuracy of the assessment (e.g. when data are collected through standard questionnaires across companies operating in different sectors, and there is not direct exchange with the rated companies);
- sometimes users are **not entirely satisfied with the explanations** that they receive from their providers when they challenge them on specific data points.

Additionally, **the way in which investors perceive the quality of the ESG ratings very much depend on each individual user's objective.**

Q28: Do you consider that there are any significant biases with the methodology used by the providers?	
Yes	X
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	X
Biases based on the location of the company	X
Other biases	X
Don’t know / no opinion / not applicable	
If you responded “other biases” to the previous question, please explain which ones:	

Eurosif has been presented by several users with several instances where biases may occur within the methodologies of ESG ratings providers. Besides the size and the location of the companies rated, for instance, different ESG ratings providers tend to evaluate in different ways the **situations where companies do not disclose certain information**. Reasons and outcomes of these differences are often unclear to investors, who may misinterpret the meaning of the final assessment. For instance, for some providers a low environmental rating can mean that a company has a poor performance, for others that a company has not provided any information on some elements that were pondered in the final assessment. This issue also affects the possibility for users to **compare** appropriately the ratings furnished by different providers.

The different treatment of not-disclosed information might further penalise companies from **jurisdictions with less sustainability reporting requirements** and **small and medium enterprises** which have less resources and skills to report on ESG factors.

As regards the treatment of larger companies vis á vis smaller companies, it might be also noted that larger companies may be more prone to the detection of controversies than smaller companies, which brings to a downgrade of the score.

The outcomes of ESG ratings can also be biased by the **reference industry** of the company assessed. For instance, methodologies tilted towards environmental considerations might be inclined to assign relatively high overall ratings to companies that operate in certain sectors (e.g. Tech and Pharmaceuticals), due to underestimation of controversies or poor performance on social and governance aspects.

However many users state that **it is often possible to detect these characteristics of the methodologies within the documents that are made available by the providers and this is part of the continuous due diligence process for the procurement of ESG ratings and data**. Moreover, Eurosif understands several providers have already put in place in their methodologies criteria to improve a consistent evaluation across different sectors, locations, and characteristics of the rated companies.

Q29: Do you think the current level of <u>correlation</u> between ratings assessing the same sustainability aspects is adequate?	
Yes	X
No	
Don't know / no opinion / not applicable	
Please explain your answer:	

Academic research and market analyses have demonstrated that **the correlation of ESG ratings is currently low**. However, users and providers tend to agree that **this is not necessarily an issue** as ESG ratings are opinions, i.e. each one evaluates different aspects of an entity, from a different angle, and with a different methodology. Rather, **a plurality of views is beneficial** for the market because it enables investors to form a multifaceted and nuanced view of a particular company, hence to adopt more sound investment decisions. The most advanced asset managers already take advantage of this aspect, as they have developed proprietary methodologies to aggregate different ESG ratings with in-house ESG research and produce their own assessments. These internal methodologies are often driven by the fact that no single service offering meets their need or because they take a specific view on particular ESG themes which may be different from that of providers.

As a consequence, **transparency on the methodologies is crucial**, as investors need to understand the meaning of each ESG rating in order to fully appreciate the implications of multiple perspectives on the same sustainability aspect and/or on the same company, and to analyse them in comparison.

Q30: To what degree do you consider that a <u>low level of correlation between various types of ESG ratings can cause problems</u> for your business and investment decision, as an investor or a rated company, on a scale from 1 (no problem) to 10 (significant problem)?

Rate: 3

A low level of correlation of ESG ratings does not per se represent a problem for users, provided a sufficient transparency on the methodologies is ensured. [See answer to the previous question.]

If we expand our focus and consider the whole spectrum of ESG ratings & data products, **investors would expect that ESG data on performance measurements** (e.g. carbon intensity, SFDR PAIIs, Taxonomy-alignment, etc.) **are as coherent as possible** across different providers' data sets. This is relevant also for ESG ratings, as assessments are based on data.

However, users frequently notice **significant discrepancies** between data from different providers. This is mainly due to the fact that data providers often elaborate on information publicly reported by companies and fill the gaps for missing data with alternatives, estimates, and proxies. In these cases, they make methodological choices based on discretion which may lead to different outcomes.

Therefore, **transparency on data sources and methodologies is fundamental across the whole spectrum of ESG ratings & data products**.

Q31: 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	5
The providers do not communicate and disclose the relevant underlying information	5
The providers use very different methodologies	2
ESG ratings have different objectives (they assess different sustainability aspects)	2
Other issue(s)	

Q32: 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	X
Rather negative	
Don't know / no opinion / not applicable	

Please explain your response to the previous question.

We believe a variety of types of ESG ratings is **beneficial for the market**, as investors are enabled to form a **multifaceted and nuanced view of a particular company**, hence to adopt more sound investment decisions. A plurality of views is also essential to the functioning of the market, for investors with **different objectives and time-horizons**.

Having said that, **transparency on the methodologies** by providers, and a **proper analysis & due diligence** conducted by investors are crucial to ensure an appropriate use is made of products.

Q33: 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)? Please, explain your answer:

Rate: 7

ESG ratings providers are often part of larger groups offering different types of products and services. This condition might potentially generate conflicts of interest, which in turn can affect the quality of ESG ratings. The risk will keep on increasing as long as ESG ratings &

data providers expand and offer additional services. However, at this stage Eurosif does not have any evidence as to whether, how and to what extent these dynamics concretely unfold in the market.

Based on consultations with practitioners, Eurosif understands that even most users believe they are not in the position to understand when a specific rating outcome might involve a conflict of interest. While acknowledging the existence of the risk, most users do not have either a direct vision, nor factual proofs about the characteristics and the scale of the phenomenon as a whole.

On the other hand, it should be considered that ESG ratings providers are strongly inclined to ensure they are perceived by the market as impartial, rigorous, and reliant in their assessments, as these qualities are essential components of their business model. Therefore, **providers themselves have already strong interest in avoiding any situation that can potentially generate suspicions or reputational damages and hinder their credibility,** which in turn would erode their market space. Most providers, indeed, already disclose publicly on their websites the policies to prevent and manage conflicts of interest. Some providers split the analysts and the sales departments.

Bearing in mind these dynamics, Eurosif supports a **regulatory initiative aimed at introducing transparency requirements for providers** on the policies and the internal processes adopted to prevent, mitigate and manage potential conflicts of interest. A legislative action on this subject should be aimed at ensuring that all providers disclose the information that are **useful for users to trust the reliability of the ESG ratings**. A regulatory framework would also be crucial to hold providers accountable for the information that they disclose.

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	X
Where providers charge companies to see their own reports	
In the absence of separation of sales and analytical teams	X
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	X
In the lack of public disclosure of the management of potential conflicts of interest	X
Other conflict(s) of interest	X

If you responded "other(s) conflicts of interest" to the previous question, please specify the additional risks you see:

In theory, conflicts of interest might potentially arise at least in three types of situations where ESG ratings providers and investors are involved.

- **Providers selling products based on a "issuer pays" model (e.g. credit ratings) and products based on an "investor pays" model (e.g. ESG ratings)** – a conflict of interest might potentially occur when investors buy ESG ratings on companies, and get their credit risk rated by the same provider. A similar situation may exist when rating financial instruments issued by a company such as green bonds or sustainability-linked bonds.

- **Providers offering ESG ratings on companies as well as on funds and products** –for instance, a potential conflict of interest might occur when investors buy ESG ratings on companies, and have their funds rated from the same provider (i.e. investors are clients, and at the same time their funds are rated by their provider).

- **Providers offering ESG ratings on companies as well as indexes for passive investment strategies** – a conflict might arise when the ratings that are assigned to a company are influenced by the weight that the same company has in the benchmark (e.g. big companies might receive inflated ESG ratings because they are important constituents in the indexes marketed by the same provider, so dropping them for ESG reasons might create problems in terms of tracking error).

Q34: 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)?
Rate: 5
Please, explain your answer:
Although a few providers hold most market shares in traditional risk-based ESG ratings, small-sized entrants can find opportunities by offering products highly specialised on subjects that are becoming emerging trends, and where there is a lack of data-driven knowledge (e.g. biodiversity, impact, water-use, etc).

Q35: What barriers do you see for smaller providers?
For smaller providers willing to enter the market and remain competitive, the main challenge is offering the widest possible **coverage** in terms of rated entities to cover as much as possible the entire investable universe of large asset owners and asset managers. This challenge may be more relevant for providers of ESG data, rather than for providers of ESG ratings.

Q36: 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)?
Rate: 5 In general, **the providers' size and market share, and the coverage of their products are self-reinforcing factors**. Larger providers have more capabilities to keep and enlarge the coverage of their products. Some users, in turn, tend to prefer larger providers because their products cover more companies – this is particularly the case of users that have less resources available. However, **smaller providers highly-specialised on specific topics and pivoting on quality can find their niche** by addressing the needs of asset managers focused on specific topics (e.g. thematic funds), and/or with more sophisticated investment strategies.

Q37: 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)?
Rate: 6 The satisfaction of the users of ESG ratings may depend on two factors (among others): the **coverage** (in terms of companies rated and/or topics analysed) and the **granularity of the assessment**. **Users have very diverse expectations from ESG ratings, depending on the use** that they intend to make of the information obtained. Asset managers with more resources available and/or with more sophisticated or with specialised sustainable investment strategies, can focus more on the granularity of the analysis on specific topics or indicators, and can rely to multiple providers to expand the coverage. Asset managers with less resources available would also need to consider achieving the widest coverage possible from each individual provider. Based on these considerations, the response to this question can vary across users, depending on the needs and expectations. That said, Eurosif has been informed about several cases where **users have faced a significant increase of the budget allocated to ESG ratings & data products**. In some cases, this is due to the augmented volume of services and products used. In other cases, the increase of the price of single ESG ratings & data products may be motivated by the necessity of the data providers to expand their capabilities with the aim of improving coverage and quality of the services offered. On the other hand, some users have reported some cases of

increased prices for similar data services offerings without clear explanation for these increases.

Q38: Do you consider that <u>information on the fees charged</u> by the providers is sufficiently transparent and clear?	
Yes	
No	X
No opinion	
If you responded "no" to the previous question, please specify what you consider should be the minimum information to be disclosed.	
Several users have reported to Eurosif that in most cases they do **not have visibility into the structure of the fees** charged for each product, which may vary significantly depending on multiple aspects, including the type of clients. For example, from multiple sources we have heard about instances whereby **some providers charge different fees for the same product offering depending on the size and category of market participant**. In some cases it is perceived as an artificial way to increase demand for certain services by users. We believe that **more clarity on a set of basic information on the criteria followed by each individual provider to charge fees** to their (potential) clients would be beneficial to promote efficiency in the market.	

III - EU intervention

Need for an EU intervention	
Q39: Taking into account your responses to the previous sections, do you consider that there is a <u>need for an intervention</u> at EU level to remedy the issues identified on the ESG rating market?	
Yes	X
No	
Don't know / no opinion / not applicable	
Please explain why:	
Eurosif is supportive of an EU legislative framework for the market of ESG ratings providers. In particular, we see three main domains where a regulation may help to **improve transparency** and promote a more efficient functioning of the market around: • methodologies and their robustness; • management of potential conflicts of interest; • pricing and fee structures.	

More **transparency on methodologies** would ensure that investors have easy access to the basic information that are necessary to understand and make an appropriate use of ESG ratings in their investment strategies, and ultimately put them in the condition to make well-grounded investment decisions.

Transparency on the measures adopted by providers to **prevent and manage potential conflicts of interest** would strengthen the market's confidence in the impartiality of ESG ratings' providers and in the reliability of their products.

Finally, we believe that **more clarity on a set of basic information on the criteria followed by each individual provider to charge fees** to their (potential) clients would be beneficial to promote efficiency in the market, as well as a mutual understanding of providers' and users' respective needs and expectations.

We believe that transparency measures in these domains would ultimately support positive driving forces compelling the market towards an ever-increasing accuracy, quality, and coverage.

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	X
Don't know / no opinion / not applicable	

Please explain your answer:

The introduction of legally binding disclosure requirements on methodologies, potential conflicts of interest, and pricing structure would ensure that all providers disclose a basic set of relevant information, and would create an accountability system for the information disclosed.

We strongly encourage EU policymakers to consider that the space of ESG ratings includes a **wide and heterogenous range of products that are constantly and rapidly innovating**, each one featuring its technical specificity – as clearly demonstrated in our previous responses to this consultation. Therefore, it is of outmost importance that any regulatory framework is **proportionate** and focuses only on **transparency**.

In particular, Eurosif believes an EU regulatory framework in the market of ESG ratings should:

- **be proportionate**, to avoid (as much as possible) to create disadvantages for smaller providers and new market entrants;
- **not introduce granular product requirements**, which might hamper the products' diversification, and suffocate market innovation – as stated earlier, the objective is not perfect comparability of all ratings;

- **focus on clarifying the process of each individual provider to elaborate ESG ratings**, and not prescribe the adoption of specific elements in the methodologies, nor the adherence to specific definitions or criteria;
- introduce a **concise list of principle-based disclosure requirements** aimed at simply indicating the aspects that providers are required to make transparent.

Moreover, the regulatory framework should apply to **providers that sell ESG ratings in the EU market**. The legislation should not qualify asset managers developing their own ESG ratings as "ESG ratings providers", hence entities subject to the provisions. Any clarification on the role and the use of in-house-developed ESG ratings in investments decisions should be rather mandated through the SFDR templates.

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	X
Improving transparency on the methodology used by the providers	X
Improving the reliability and comparability of ratings	
Clarifying what is meant by and captured by ESG ratings, to differentiate from other tools and services	X
Clarifying objectives of different types of ESG ratings	X
Improving transparency on the fees charged by the providers	X
Avoiding potential conflicts of interests	X
Providing some supervision on the operations of these providers	X
Other measures (please specify)	X

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

As regards the **transparency on methodologies**, the following list of items should be disclosed:

- **objective** of each individual rating (e.g. risks/impacts);
- **data collection** – how the data and the information are collected, including the type of exchange with companies (e.g. public sustainability reporting; specific questionnaires sent to companies and type of information accepted as responses; direct relation of the analysts with companies; news monitoring; etc.);
- **data sourcing** – which is the relative proportion of data publicly reported by companies, and estimates contained in the data sets underlying the ESG rating; which is the exact source accessed to ponder every single indicator of the assessment;
- **data review time period** – how frequently the data are reviewed and updated, including any significant information on exceptions, or differences between certain categories of rated entities (e.g. data of small and medium sized companies are normally less timely);

- **weights of different factors and indicators**, with details on any significant criteria adopted in sub-sector classification;
- **frequency and contents of updates** in methodologies;
- **internal quality checks** on the data.

In this regard, we would underline that most ESG ratings providers already disclose these pieces of information, and in day-to-day operations users might need more detailed information, or explanations on single data points. These issues are often already solved through **bilateral dialogue between users and providers**.

In general, we want to underline that many practitioners are fully aware that regulation will not solve all the issues concerning the understanding of ESG ratings. Many issues are due to the lack of qualitative, comparable and verified data reported by companies themselves. Other issues are likely to be fixed by the evolution of the sustainable investing industry and the constant dialogue of providers with users to meet their evolving needs.

Moreover, we would reiterate here that the introduction of transparency requirements for providers should **not exempt by any means asset managers to conduct a thorough and appropriate due diligence and quality checks** on the products they are using.

Furthermore, there have been plenty of discussions regarding the lack of correlation of different ESG ratings by different providers for the same issuer. These differences are explainable and reflect the fact that ESG ratings are assessments based on proprietary methodologies. A diversity and competition of opinion is healthy for a diverse market. Therefore, **we are in no way advocating for any attempt to harmonise ESG ratings methodologies**. However, we do think an adequate level of transparency about how ratings are constructed is essential.

As regards the **transparency on potential conflicts of interest**, a list of disclosure requirements should demand providers to explain where potential conflicts of interest might arise in their business model; as well as describe which policies, organisational & governance structures they have adopted to prevent and manage said situations.

As regards the **transparency on the pricing structure**, we consider important that all ESG ratings providers disclose a set of basic information on which approach/criteria they follow to charge fees for individual products, or packages of products, including the characteristics of the clients, if relevant (for instance, the size, or whether they are existing/new clients, etc.). We are in no way advocating to limit or modify the dynamics of the negotiations that normally occur in the market. Nevertheless, we consider that an increased level of transparency would be beneficial to promote efficiency and allow both providers and users to mutually understand each ones' needs and expectations.

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

We invite policymakers to consider that over the last years – with a growing number of investors pivoting towards sustainable investing, and new disclosure requirements being adopted in EU frameworks – there has been a **significant increase in demand and use of ESG data products**. Whereas ESG ratings can be considered as "opinions" (i.e. "qualitative/quantitative assessments", as they evaluate specific aspects of a company using proprietary methodologies defined by each provider), ESG data products are **"performance measurement", as they are figures quantifying the dimension of a specific activity/output/conduct of a company**. For instance, performance measurements are: GHG emissions, carbon intensity, the Principal Adverse Impact Indicators (PAIIs) of the SFDR, or the Taxonomy alignment of a company's turnover, CapEx and OpEx.

Investors would expect the performance measurements to be **as coherent and comparable as possible** across different providers' data sets, especially as regulatory frameworks will gradually clarify the calculation rules. Nevertheless, correlation becomes more challenging when providers elaborate on information publicly reported by companies and/or fill the gaps for missing data (e.g. with alternatives, estimates, and proxies). In these cases, they make **methodological choices based on discretion, which may lead to different outcomes**. This is particularly evident for the performance measurements of the companies that are not subject to the EU regulations. Hence, these data need to be calculated by external providers. As a matter of fact, when reported information is not available (or not accurate) the discretion used by providers to input data blurs the line between opinions and performance measurements, thus rendering transparency on data sources and methodologies fundamental across the whole spectrum of ESG ratings & data products.

Therefore, we invite EU policymakers to monitor this relevant field and **analyse the evolution of the market of ESG data products**, as key pieces of legislation (such as the CSRD and its standards, the SFDR, and the Taxonomy Regulation) are gradually absorbed by financial market participants. For instance, it could be beneficial to commit to conduct an assessment of the market after 3-5 years after the entry into force of the CSRD and the reporting standards, in order to verify whether there are issues that a regulatory framework might contribute to solve.

Q40: 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	X
No	
Don't know / no opinion / not applicable	
Please explain why:	

The establishment of an authorisation/registration/notification system is necessary to allow EU regulators to enforce the legislation and hold the providers accountable for the information that they disclose.

Having acknowledged that, Eurosif advocates for the introduction of a **light-touch registration system**, with just a list of information to disclose (e.g. ideally a form to fill out). This approach would allow to avoid creating an over-complicated system with high costs for regulators and providers, and introducing rules that might inadvertently penalise smaller providers or new entrants.

Any operational requirements stemming from the authorisation/registration/notification should be as minimal as possible so as to be **proportionate for smaller players entering this market.**

Q41: 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	X
Don't know / no opinion / not applicable	
Please explain why.	

Eurosif believes the provision on **scope should focus on whether ESG ratings are provided in the EU to EU-based investors,** as the main aim of the legislation is to increase transparency and ensure robustness of the services marketed and used in the European financial markets. A universal scope that triggers an authorisation/registration requirement as soon as an EU-company or financial instrument listed in the EU is assigned an ESG rating, regardless of where the ESG rating is marketed, risks capturing unforeseen firms.

In general, we are convinced that limiting the scope would **not expose the regulatory framework to a high risk of circumvention**. Indeed, the economics of the data provision business is that once the analysis/assessment has been done on the universe of companies covered, the key objective for ESG ratings providers is to sell the same information to as many users as possible. In that sense, the European markets are highly attractive for ESG ratings providers because of the size. Therefore, we anticipate that most providers of ESG ratings would continue to be willing to sell their products in the EU, regardless of the authorisation/registration provisions.

Q42: Do you consider that there should be some <u>minimum disclosure requirements</u> in relation to methodologies used by ESG rating providers?	
Yes	X
No	
No opinion	
Please explain why:	
Eurosif supports the introduction of a set of minimum disclosure requirements. We would also underline that the disclosures should be **aimed at satisfying the information needs of professional investors** (asset owners and asset managers) as these are the main users of ESG ratings. We would point out, though, that some ESG ratings providers already provide a significant level of transparency on their methodologies. Some ratings services provide very granular and lengthy report with a lot of specific data points about each rated company. Other services can also identify the source of the data used for the calculation and indicate whether the data used is reported by the company or the result of own calculations. Therefore, we would expect providers to be able to instantly satisfy a lot of the requirements already with their existing offerings. The legislation should **distinguish between the information that providers are required to disclose to a wider public**, and the information that are **commercially sensitive** and therefore should be provided just to the clients.	

Q43: Do you consider that the providers should be using <u>standardised templates</u> for disclosing information on their methodology?	
Yes	
No	X
No opinion	
Please explain why.	
We are not certain about the usefulness of templates. Most templates in financial regulation are used to provide standardised and comparable information to retail investors (users). As mentioned above, the absolute majority of users are professional, sophisticated users looking for a high level of details and able to perform their own due diligence. The templates may not actually provide sufficiently granular information for these users. Therefore, we would **refrain from introducing templates**.	

Q44: Do you consider that the rules should be <u>tailored to the size</u> of the provider and hence have smaller providers subject to a lighter regime?	
Yes	
No	X

No opinion	
Please, explain your answer:	

The transparency requirements are aimed at ensuring that the ESG ratings have all the information that are necessary for the users to better understand the products that they are using/intend to use. Hence, the list of useful information depends on the products and not on the characteristics of the provider. Therefore, we would advocate for the **introduction of a list of disclosure requirements or principles that is sufficiently brief, concise, clear so as to allow both larger and smaller players to easily comply**.

The disclosure requirements on conflicts of interest should be equally applicable to large and small providers, as well as to existing and new entrants. The source of potential conflicts emanates from the risks associated with having a multitude of different data services within one group. Therefore, any rules requiring some set of disclosure and procedures around managing conflicts of interests are likely to be proportionate already: smaller firms with one type of service are likely to be able to implement these rules far more easily than larger, more complex providers providing a multitude of services.

Q45: 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	X
No opinion	
Please explain:	

We believe that only ESG ratings providers that sell products in the European market should be subject to the regulatory regime. We reiterate our observation on the characteristics of the economics driving the provisions of ESG ratings: once the analysis/assessment has been done on the universe of companies covered, the key objective for ESG ratings providers is to sell the same information to as many users as possible. In that sense, European markets are highly attractive for ESG ratings & data providers because of the size. Therefore, most providers of ESG ratings would continue to be willing to sell their products in the EU, regardless of the authorisation/registration provisions.

We do not quite see how rating an EU company/financial product issued or traded in the EU would in itself trigger regulatory requirements.