

**MEMO# 34103**

April 8, 2022

# **EU ESG: European Commission Consults on the EU ESG Ratings Market and on the Consideration of ESG Factors in Credit Ratings**

[34103]

April 8, 2022

TO: ICI Members

ICI Global Members

ESG Task Force

EU ESG Disclosure Regulation Working Group SUBJECTS: ESG

International/Global RE: EU ESG: European Commission Consults on the EU ESG Ratings Market and on the Consideration of ESG Factors in Credit Ratings

On 4 April 2022, the European Commission published a Targeted Consultation on the Functioning of the ESG Ratings Market in the European Union and on the Consideration of ESG Factors in Credit ratings.[\[1\]](#) The responses are due on 6 Jun 2022. The consultation is designed to help the Commission gain a better insight on the functioning of the market for ESG ratings, as well as to better understand how credit rating agencies (CRAs) incorporate ESG risks in their creditworthiness assessment.[\[2\]](#)

Next steps. Responses from market participants will feed into an impact assessment (scheduled for 2022) that will evaluate whether a possible policy initiative on ESG ratings and on sustainability factors in credit ratings is needed. Subject to the result of this impact assessment, the Commission would propose an initiative to foster the reliability, trust, and comparability of ESG ratings by early 2023.

Brief overview of the consultation. The consultation consists of two sections: ESG Ratings and Incorporation of ESG Factors in Credit Ratings.

## **ESG Ratings**

This section aims to inform the Commission on the dynamics relating to the ESG ratings market, and on the interplay between larger and smaller market players. This section also aims to inform on the use and objectives of ESG ratings. The term ESG ratings is based on the definition provided in the International Organization of Securities Commissions' (IOSCO) final report on environmental, social and governance (ESG) ratings and data products

providers (21 November 2021).[\[3\]](#)

Questions regarding use of ESG ratings and dynamics of the market (with the questions directed at investors, asset managers, benchmark administrators; and, separately, to assessed companies). In addition to the questions about the use of ESG ratings, questions explore whether users of ESG research carry out sufficient due diligence "to ensure an acceptable level of quality"; if "no," whether there is merit in refining the current definition of research under Directive 2014/65/EU, and whether ESG research products have reached sufficient level of maturity and comparability to allow users to fully understand the products they use.

Questions regarding functioning of the ESG ratings market. These questions aim to inform the Commission about functioning of the market and potential issues that hamper its development and trust by market participants. In this regard, the questions ask to rate a list of shortcomings (from lack of transparency on the methodologies to lack of supervision and enforcement over the functioning of this market), ask about the quality of the ratings, biases in the methodology, correlation between ratings assessing the same sustainability aspects, views on the existence of a variety of ESG ratings, conflicts of interest, access to the market by small providers, and the fees charged for ESG ratings.

Questions regarding an EU intervention. These questions seek to gather stakeholder views on the need and type of possible intervention at EU level, and its costs/benefits. Among others, the questions explore whether providers should be subject to an authorization or registration system in order to offer the services in the EU; whether there should be some minimum disclosure requirements in relation to methodologies used by ESG rating providers; and whether the providers should be using standardized templates for disclosing information on their methodology.

In ICI's March 2022 response to the Call for Evidence on the EU ESG Ratings Market[\[4\]](#) conducted by the European Securities and Markets Authority (ESMA), we stated that regulatory intervention for this market was premature, but we expressed support for the concept of industry-developed codes of conduct for ESG ratings and data providers, which generally could be based on the IOSCO's high-level recommendations.[\[5\]](#)

## **Incorporation of ESG Factors in Credit Ratings**

This section seeks to identify possible shortcomings in relation to the consideration of sustainability risks in credit ratings and the disclosures made by CRAs. The consultation observes the highly regulated nature of credit ratings in the EU and specifically refers to ESMA's Guidelines on Disclosure Requirements Applicable to Credit Ratings that address the relevance of ESG factors to credit ratings.[\[6\]](#)

These ESMA Guidelines expect CRAs to identify in their press releases if ESG factors have been key drivers behind a change in the credit rating. CRAs are asked to identify relevant factors, elaborate on their materiality, and provide a reference to the methodology or the associated model. The ESMA Guidelines came into effect in April 2020. The consultation observes that a recent assessment of the application of the Guidelines revealed that the improvement of transparency has been partial and not uniform. The consultation questions build on these findings.

The questions seek information on whether users utilize credit ratings for investment decisions, whether it is important for users to understand to what extent individual credit rating actions have been influenced by sustainability factors, whether CRA methodologies

regarding incorporating sustainability factors are well disclosed, and what the trends are with respect to the incorporation of ESG factors in the credit rating process and methodologies.

Questions addressed to CRAs seek information on whether and how CRAs incorporate ESG factors in their methodologies and whether they improved disclosure on ESG factors in credit ratings since April 2020 when ESMA Guidelines became applicable. The final section seeks input on potential options for further EU intervention, and its potential additional costs/benefits.

Anna Driggs  
Director and Associate Chief Counsel  
ICI Global

#### **endnotes**

[1] See [https://ec.europa.eu/info/consultations/finance-2022-esg-ratings\\_en](https://ec.europa.eu/info/consultations/finance-2022-esg-ratings_en).

[2] This consultation is also being informed by feedback from Call for Evidence Regarding ESG Ratings conducted by the European Securities and Markets Authority (ESMA) in early 2022, see Memorandum [34029] (dated 8 February 2022), available at <https://www.ici.org/memo34029>, and see ICI's response, Memorandum [34073] (dated 11 March 2022), available at <https://www.ici.org/memo34073>.

[3] See Memorandum [33922] (dated 24 November 2021), available at <https://www.ici.org/memo33922>.

[4] See n.2.

[5] See n.3.

[6] See <https://www.esma.europa.eu/document/final-report-guidelines-disclosure-requirements-applicable-credit-rating-agencies>.