Dear Sirs,

These comments the RSFS survey are provided from the perspective of a national competent authority responsible for the Croatian non-banking financial market. We agree with “Opportunities and Challenges” identified and presented in ESMA’s response to the RSFS survey, and generally support the comments provided by ESMA. However, we are also taking this opportunity to provide some further comments for consideration, focusing on smaller markets and the issue of SME access to finance, including SME’s seeking “green financing”.

In line with the comments submitted by ESMA, we find it necessary to set up an adequate legislative framework for ESG rating service providers in order to create a sound platform for sustainable finance (SF) development. One priority should likely also be to enhance the existing CRA framework when it comes to ESG rating methodologies, giving the market access to comparable ratings for issuers and enabling users of such ratings to make informed investment decisions. The ESG investment market needs to be based on credible ESG ratings to properly grow and for a critical number of relevant ESG investment opportunities to present themselves.

We also agree that there is no imminent need to set up additional ESG ratings for investment funds, as the implementation of the SF framework has only just started. We should first focus on evaluating the effects of implementing the existing SF framework on financial market participants (FMPs), including investment funds, before considering the introduction of new types of ratings. FMPs are facing substantial adjustments to their existing business conduct and practices in relation to the implementation of SF framework and their existing resources are under significant pressure.

On the idea of establishing separate trading venues (TV) or trading segments on existing TVs for listing and trading ESG instruments, we are more cautious (ESMA agreed with this proposal (Q 36)). This could be premature before a sufficient number of ESG investment opportunities arise, and could even cause market fragmentation and liquidity issues for such instruments, which could compromise the „EU green deal“ project and erode investor trust.

The idea of market operators taking up the role of ESG investments educators[[1]](#footnote-1) isapositive one, but should not disregard the fact that not all market operators can provide such services, or provide them at the same level. This is dependent on available human resources (requiring specific expertise) and financial constraints, especially in smaller markets. The education of FMPs, issuers and other provisional and retail investors on ESG investments should have a prominent role in the Commission agenda, with multiple channels of information flows to the market and a program to help with the funding needs and how to pool existing expertise, present in the Commission, the ESAs, national competent authorities and the industry.

We can also support the establishment of a centralized digital data hub such as ESAP that would make available both financial (FI) and non-financial information (NFI) to a larger universe of investors. This may in fact be a precondition to the expansion of cross-border SF investments. However, we find that a gradual approach is needed, one based on the principles of proportionality, to avoid potential negative side effects of imposing burdensome rules on smaller companies such as SMEs, listed or not, that may discourage the take up of the SF agenda. This is obviously linked to the ongoing discussion on the revision of the Non-financial reporting Directive (NFRD) and how we will ensure consistency and synergy of future legislative drafts with the current SF framework. This applies to both possible widening of the scope of supervised entities and to how NFI disclosures and positioning in relation to financial reports are to be defined.

The success of the European green deal it is contingent on getting a majority of EU enterprises to „get on board “ when it comes to „greening“ their business activities. This is a prerequisite to realize the full effects of introducing a sustainable finance legislative framework. From this perspective, it seems counterintuitive to rely solely on large issuers (NFRD) and public interest entities. The backbone of the EU economy consists of numerous SMEs, both listed and unlisted, that account for more than 90% of all EU corporates. This doesn’t mean that SMEs should have the same requirements as large issuers, or that the requirements should not be phased in and combined with incentives for voluntary participations, but SMEs should be a part of the framework in the medium-to-long-term, in order to facilitate an efficient transition path towards sustainable business models in general. Here, it will be crucial to frame and implement requirements for SMEs in a proportionate way and to combine them with appropriate incentives. It will also be crucial not to make access to “green” labels too difficult or expensive for SMEs, as SMEs financing needs do not necessarily gravitate towards large amounts. Costs related to financial arrangements when seeking “green financing” can act as a significant deterrent for SMEs’ participation.

With this in mind, we see two potential obstacles to developing a „green financing“ orientation by SMEs: one is connected to costs related to arranging “green” transactions and other to the development of national and regional ESG/GBS rating and label services providers/verifiers that are familiar with local markets specificities and could actively promote the shift towards “green financing”.

Moving too quickly towards an EU level supervisory model of ESG rating firms and GBS verifiers, instead of applying a bottom-up approach, can drive smaller firms out of business and seriously curtail access for SMEs. An EU supervisory model implies pan-European significance, and would therefore largely be adapted to such firms, driving up operational and supervisory costs. The outcome could be that the increase in costs could be significant enough that it can only be borne by larger ESG ratings/GBS verifiers firms given their global business activities, while for mid-size/small rating firms/verifiers this would represent a burden that their business models would not be able to sustain. This would have an impact on access for SMEs, especially those from smaller markets – fees of global rating houses related to issuing ratings/labels are usually much higher than those of providers focused on regional/national markets. Such increased rating/labelling costs may seriously discourage SMEs in seeking financing options with ESG ratings and GBS labels stamps. As ESMA rightly notes in its response to this consultation, GB issuers and ESG ratings firms markets are both underdeveloped and highly concentrated, and ESG ratings market can be characterized to a significant degree as an oligopoly. ESMA has suggested to move towards an EU level supervisory model as adequate way of dealing with these risks, however, we do not share this view for two reasons.

1. As is the case with CRAs, an EU level supervisory model is unlikely to solve the practical oligopoly problem,
2. An EU supervisory model is unlikely to contribute to the development of regional/national service providers.

On the second issue, we are concerned that an EU supervisory model will likely lead to an access problem instead and cement the oligopoly further, which is contrary to the overall policy objective. Regional/national service providers have the advantage of being familiar with local markets and should be encouraged, as this would improve access for SMEs and contribute to getting local SMEs “on board” to seek green financing resources. There is also issue of adequate ESMA supervisory resources in case numerous providers emerge. Therefore, we would suggest a bottom-up approach that would start at the national level and build from there, possibly with a parallel “28-th” regime in place for pan-European providers where ESMA would be the EU level supervisor for such systemic entities. We believe that the development of regional/national ESG/GBS services providers/verifiers would be better served by a national supervision framework, also because the NCAs would then have under their supervisory remit the whole chain of sustainable finance related participants, from issuers to rating providers, distributors and institutional investors (SFDR).

A national supervisory model could also enable a swifter detection of potential problems. It would also be consistent with the general sustainable finance legal framework (SFDR, taxonomy…) as it is already based on a national supervision model. ESMA, however, will have an important role to play to ensure supervisory convergence in this new area and as a centralized hub of ESG/GBS related data.

The survey also addresses the „supply chain due diligence“ process. ESMA commented that, when it comes to SMEs, this should be limited to SMEs doing business in „risky“ sectors. While we share the goal that we should not overburden SMEs, we caution that the definition of “risky” sectors will not necessarily capture all enterprises that could have issues with the „supply chain due diligence“ process. This especially relates to the “S” part of ESG. In the ongoing COVID pandemic, we witnessed circumstances like the spread of the contagion among employees working in sub-optimal, un-hygienic conditions and without minimum health protection (cattle farms and meat manufacturers in some of the MS). The definition would need to be very flexible to avoid these issues going forward. Alternatively, a proportionate approach could be considered where the scope would be wide, but with a lighter regime introduced for SMEs.

Thank you for providing us the opportunity to share our comments!

1. i.e. “Sharing of existing standards, principles or best practices, together with the deployment of educational resources and expert assistance can improve understanding ESG investment risks and advantages, and consequently attract investors on this market” [↑](#footnote-ref-1)