SUMMARY REPORT

Targeted consultation on the functioning of the ESG ratings market in the EU and on the consideration of ESG factors in credit ratings

I. INTRODUCTION

This report gives an overview of the results of the targeted consultation on "ESG ratings and ESG factors in credit ratings", carried out between 4 April and 10 June 2022. 168 responses were received to the online questionnaire. All responses, including 36 accompanying letters were considered. Percentages mentioned in this summary report are based on respondents who expressed an opinion on the relevant question.

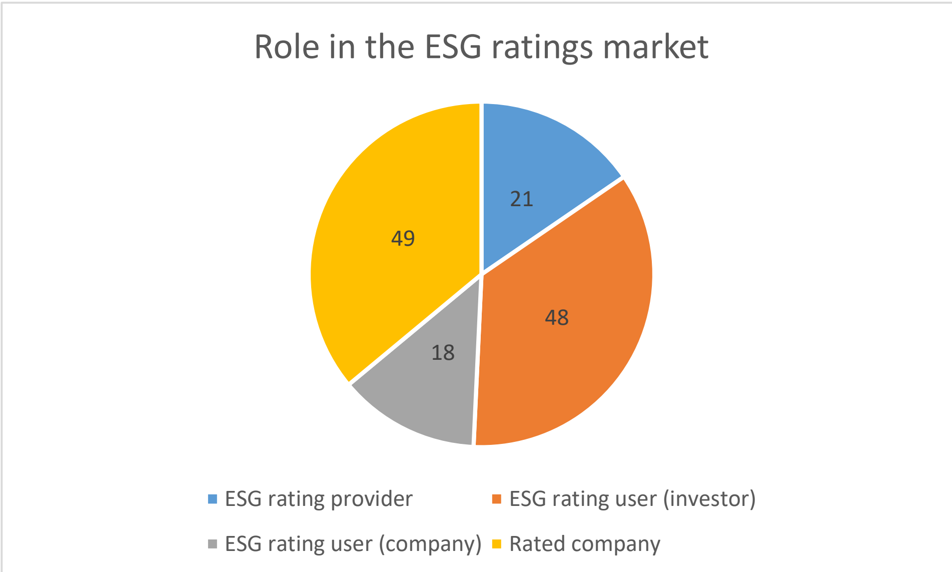
Disclaimer*: This document should be regarded solely as a summary of the contributions to the public consultation. It cannot in any circumstances be regarded as the official position of the Commission or its services. Responses to the consultation activities cannot be considered as representative sample of the views of the EU population.*

II. OVERVIEW OF RESPONDENTS

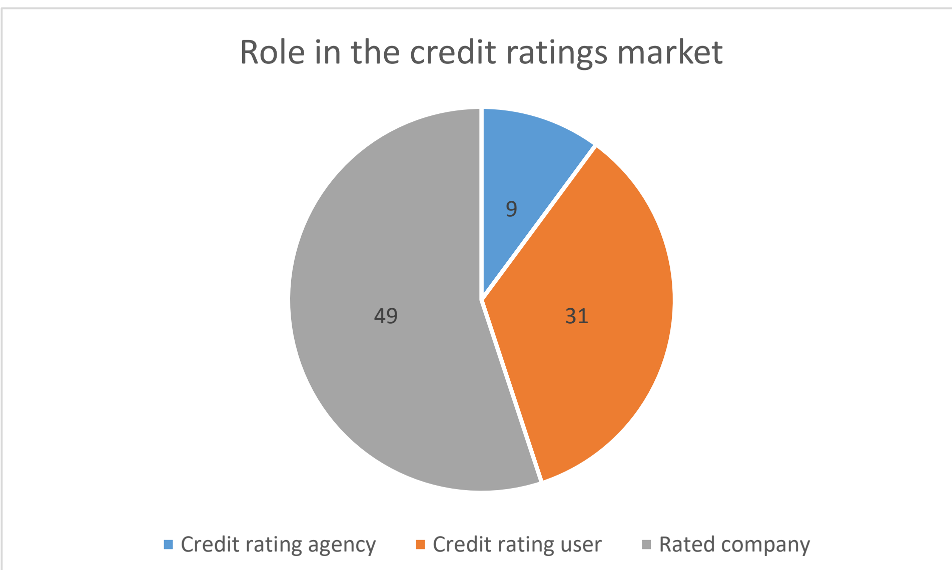
A majority of respondents (77%) represented the private sector, including mainly business organisations and companies, but also professional associations. 56% of the companies were large, with more than 250 employees. In addition, NGOs represented 8% of respondents, public authorities 3%, and trade unions 1%. As regards the field of activity, over one third of respondents declared being active in financial services.

Overall, around 80% of the respondents were from the EU (from 13 Member States), in particular from France (23%), Belgium (15%), Germany (14%) and Italy (8%). Third country respondents were mainly from the United Kingdom, the United States, Norway and Switzerland.

Respondents identified their role(s) in the ESG ratings market, as shown in the figure below. Many respondents indicated that they had several roles, in which case a 'primary' role was designated for the purposes of the analysis.



Respondents also identified their role(s) in the credit ratings market, as shown in the figure below. Most respondents indicated that they had several roles, in which case a 'primary' role was designated for the purposes of the analysis.



III. RESULTS OF THE PUBLIC CONSULTATION

3.1 Use of ESG ratings and dynamics of the market

The vast majority of respondents declare that they do use ESG ratings and among these, 77% use them 'very much', while a smaller share use them 'a little'.

Three quarters of responding investors use – among others – ESG ratings providing an opinion on the impact of companies on the society and environment. The most used ESG ratings appear to be those that provide an opinion on exposure to and management of ESG risks; 86% of respondents use this type of rating, among others.

The large majority of respondents (81%) use a combination of overall ESG ratings with E, S, G or even more granular ratings. A smaller share of respondents use either only overall ESG ratings or only ratings of specific elements within E, S or G factors. Several respondents also use controversy scores or assessments, exclusion lists, and UN-SDG alignment assessments. The majority of respondents (61%) buy ESG ratings as part of a package, with other ESG data or services such as screening, controversy alerts, benchmarks, regulatory compliance checks and fund ratings.

Almost all respondents replied that they value and need transparency in data sourcing and methodologies and timeliness, accuracy and reliability of ESG ratings. Over half also mentioned they value the rating report explaining the final score or aggregated score, as well as the scores themselves.

For half of the respondents, ESG ratings are determinant in assessing the way they manage sustainability risks and opportunities and their impact on the outside world. Respondents also use other means to assess their sustainability management and impact, such as; internal materiality assessments, level of compliance with national or international requirements, external assessments by consulting services, engagement with their stakeholders, and benchmarking against their peers. The large majority of respondents (82%) indicated that they refer to ESG ratings in public documents or materials.

On the level of competition of the ESG ratings market, views are mixed, with an almost identical percentage of respondents considering the market to be competitive and not competitive. The largest share of views of respondents were neutral on this.

Almost all respondents expect the ESG ratings market to grow. Respondents consider the decisive factors in this growth to be growth in demand from investors in ratings of companies for their investment decisions, followed by further standardisation of information disclosed by companies and other market participants, and then growth in demand from companies in ratings including on rating future strategies.

The majority of respondents, in total and within each main user group, expect to increase their usage of ESG ratings, at least to some degree but often to a large degree. This expected increase is most marked for investor users.

The large majority of respondents (81%) use ESG ratings mostly or exclusively from large market players. The majority of respondents (60%) consider that the current market conditions make it difficult for smaller market players to enter the market and to remain competitive.

3.2 Functioning of the ESG ratings market

The large majority of respondents (over 84%) consider that the market is not functioning well today. On the quality of ESG ratings, two thirds of respondents consider the quality to be fine to very good, with about one third considering it poor. A large majority of respondents (83%) consider that the lack of transparency on the methodologies used by the providers is a problem in the ESG ratings market. The vast majority of respondents (91%) also consider that there are significant biases with the methodology used by providers. The large majority of respondents (over 80%) also consider that the market is prone to potential conflicts of interests.

On the current level of correlation of ESG ratings, the large majority of respondents (81%) consider that it is not adequate. The main reason for the lack of correlation according to users of ESG ratings is the lack of transparency on the methodology and objectives of the respective ratings and the fact that ESG rating providers would not communicate and disclose the relevant underlying information. The majority of respondents (74%) however expressed support for having a variety of types of ESG ratings offered in the market assessing different sustainability aspects.

3.3 Intervention in the ESG ratings market

Almost all respondents (94%) consider that intervention is necessary, of which the large majority (80%+) support a legislative intervention with the remainder supporting the development of non-regulatory intervention in the form of guidelines, code of conduct. Respondents largely indicated (90%+) that the main element to be addressed by the intervention should be improving transparency on the methodology used by ESG rating providers, followed by avoiding potential conflicts of interests (80%), improving reliability and comparability of ratings (73%), clarifying objectives of different types of ratings (70%), and clarifying what is meant by and captured by ratings (68%).

The vast majority of respondents (82%) consider that ESG rating providers should be subject to some form of authorisation/registration regime in order to offer their services in the EU. The vast majority of respondents (94%) do not think that providers located outside the EU, but providing services in the EU, should be subject to a lighter regime. Almost all respondents (97%) consider that ESG rating providers should be subject to minimum disclosure requirements in relation to their methodologies, and most consider that they should be using standardised templates. A slight majority of respondents (58%) do not consider that the rules should be tailored to the size of market players, i.e. establishing a lighter regime for smaller players.

Relatively few replies were received on costs of a possible intervention, where many stakeholders observed that it is difficult to estimate the magnitude of costs at this stage. Costs would differ by the type of disclosures or complexity of authorisation, with stakeholders often indicating time intensity of the expected tasks in the upper ranges provided in the questionnaire. Stakeholders also often pointed out a need for proportionate rules to keep the burden limited.

3.4 Incorporation of ESG factors in credit ratings

Credit ratings are used by the large majority of respondents for investment decisions (48 out of 55), but they are only decisive for 9% of respondents; they are rather one of many sources of information (for 51%) or a starting point (for 13%).

For a large majority of users it is either very important (60%) or important (34%) to understand to what extent individual credit rating actions have been influenced by sustainability factors. As far as the incorporation of ESG factors in the methodologies and rating process is concerned, respondents are divided as to whether it is sufficient or insufficient overall. However, notably, most respondents (70%) do not find information about the extent to which CRAs’ methodologies or the rating process incorporate sustainability factors to be sufficiently well disclosed. However, the vast majority of respondents (93%) note that the level of disclosure differs depending on individual CRAs.

On the other hand, most respondents do find that the level of disclosures as to which credit ratings actions have been influenced by sustainability factors has improved sufficiently, with some laggards, (66%).

As for the CRAs themselves, 7 CRAs replied to questions directed to them. All replied that they explicitly incorporate ESG factors in methodologies and that they all incorporate all types of factors: E, S and G. They all state that they have a framework or a document describing how they incorporate ESG factors in the credit rating process. They all claim to have improved disclosures on ESG factors and to follow ESMA Guidelines on disclosures.

The majority (5 out of 7) consider the current trends are sufficient to ensure that CRAs incorporate relevant ESG factors in credit ratings. Only one CRA sees the need for further detailing of ESMA Guidelines on disclosures. In the case of EU intervention, the majority sees the risk of too much prominence given to ESG factors as compared with other factors relevant for the assessment of creditworthiness.

3.5 Intervention in the credit ratings market

Slightly more respondents consider that the current trends in the market are sufficient to ensure that CRAs incorporate relevant ESG factors in credit ratings (52 out of 101), than those who disagree.

As far as enabling users' understanding of how ESG factors influence credit ratings is concerned, the majority (72%) do not consider market trends and ESMA Guidelines to be sufficient. However, out of those who do not consider the current situation sufficient, the majority favours a non-legislative approach (56%), i.e. further detailing ESMA Guidelines and/or further supervisory actions by ESMA.

Regarding costs, stakeholders saw little or only limited additional costs of disclosing according to ESMA's guidelines compared to practices before their introduction or if disclosing according to them were to become mandatory. Some expressed concerns regarding additional compliance costs if EU legislation explicitly required CRAs to take into account ESG factors where relevant in the rating process.

IV. NEXT STEPS

The results of the targeted consultation have been processed and will be reflected accordingly in the preparation of any further Commission's initiative in this regard. A summary of all consultation activities will be included in the impact assessment of any further Commission's initiative.