**Barclays Response to European Commission targeted consultation on the functioning of the ESG ratings market in the European Union and on the consideration of ESG factors in credit ratings**

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Barclays is a universal consumer and wholesale bank with global reach, offering products and services across personal, corporate and investment banking, credit cards and wealth management. With over 330 years of history and expertise in banking, Barclays operates in over 40 countries and employs approximately 85,000 people. Barclays moves, lends, invests and protects money for customers and clients worldwide.

We welcome the opportunity to respond to the European Commission’s targeted consultation on the functioning of the ESG ratings market in the European Union and on the consideration of ESG factors in credit ratings

**Executive Summary**

Barclays is pleased to submit this response to the European Commission’s targeted consultation on the functioning of the ESG ratings market in the European Union and on the consideration of ESG factors in credit ratings (“the Consultation”).

As investors’ focus on ESG matters continues to increase and the markets require increasing volumes of data to comply with sustainability disclosures regulatory requirements, the use of environmental, social and governance (ESG) ratings is having an increasingly important impact on the operation of capital markets.

Despite their ever increasing importance, there are significant challenges related to a lack of transparency on (i) the sourcing of ESG data, (ii) the methodologies used in the calculation of the ESG rating and (iii) the intended use of the ESG rating (e.g. measuring ESG risk or sustainability impact). These issues lead to poor correlation between ESG ratings and to confusion among users.

As ESG investing becomes more common, the shortcomings and concerns expressed in this response could become a clear and present risk, potentially causing distortions in the capital allocation process. To this end, we believe that regulatory intervention is required to correct these market failures. This intervention should be consistent with IOSCO’s recommendations for securities markets regulators[[1]](#footnote-2). We would additionally suggest that the European Commission works closely with other jurisdictions that are also considering intervention to avoid regulatory fragmentation. In the short term, EU intervention should address these issues through guidelines on transparency and governance and by drawing common definitions and best practices. Any measures should be developed in line with existing and upcoming sustainability disclosure requirements, and aim at improving the availability of reliable information.

Yours sincerely,

**BARCLAYS**

# **PART A – ESG RATINGS**

## **Use of ESG ratings and dynamics of the market**

**Section 1: Questions for investors, asset managers and benchmark administrators**

**Q1. Do you use ESG ratings?**

* Yes, very much
* Yes, a little
* No

**Please explain**

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| * Barclays uses ESG ratings both as a user (for instance, as part of product development and sell-side investment research) and as an entity covered by ESG ratings providers. Some of our uses of ESG ratings are:   + Our credit trading desk has integrated one ESG rating provider into its execution platform.   + Equities structuring rely on ESG ratings for desk strategies and indices. The scores create the basis of rebalancing signals.   + ESG-screened collateral using ESG ratings.   + An analysis of environmental, social and governance factors, including a review of ESG ratings, is integrated in to our discretionary investment due diligence process.   + ESG ratings are considered in our sell-side research. |

**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
* ESG ratings providing an opinion on the compliance of companies with frameworks and rules
* Exposure to and management of ESG risks
* ESG ratings providing an opinion on a company performance towards certain objectives
* ESG ratings providing an opinion on the impact of companies on the society and environment
* ESG ratings providing an opinion on the ESG profile of the company

ESG ratings providing an opinion on investment funds or other financial products (please specify which financial products):

* Investment funds
* Others (comment box)

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| ESG rating providers’ opinions on green debt issuance and other sustainability linked-instruments such as loans. |

* Exposure to and management of ESG risks
* Impact on the society and environment
* ESG characteristics
* Other specialised ratings
* None
* Not applicable

**Q3. If you responded that you use specialised ratings, please indicate which one(s):**

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| Further examples include Taxonomy, Paris, and net-zero alignment 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)**

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

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**Q6. Do you use overall ESG ratings or ratings of individual Environmental, Social or Governance factors?**

* Overall ESG ratings
* Ratings of an individual Environmental, Social and Governance factors
* Ratings of specific elements within the Environmental, Social and Governance factors,
* Other types, please specify

**Q7. Do you buy ESG ratings as a part of a larger package of services?**

* Yes
* No
* Not applicable

**Q8. If you responded yes to the previous question, what other services do you buy?**

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| Packages of services include ESG screening, company and fund ratings, controversy screenings, ESG data. |

**Q9. 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?**

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**Q10. What are you using ESG ratings for? (multiple choice)**

* as a starting point for internal analysis
* as one of many sources of information that influence the investment decisions
* to meet regulatory or reporting requirements
* as a decisive input into an investment decision
* as a reference in financial contracts and collaterals
* for risk management purposes
* other(s).

**Q11. If you use ESG ratings for other purposes, please specify which ones?**

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**Q12. As a benchmark administrator, how do you take into account ESG ratings for the construction of a benchmark and/or in disclosures around a benchmark?**

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| N/A |

**Q13. Do you refer to ESG ratings in any public documents or materials?**

* Yes
* No

**Q14. If you responded yes to the previous question, specify the type of documents of materials**

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| As an example, with respect to our Private Bank, for our sustainable returns strategy, we highlight the aggregate ESG rating of the portfolio in product pitch books. We also mention our MSCI determined ESG rating in our annual Sustainable Portfolio Management Report which is shared on our external website and sent to clients / prospects. |

**Q15. What do you value and need most in ESG ratings?**

* transparency in data sourcing and methodologies,
* timeliness, accuracy and reliability of ESG ratings,
* final score of individual factors
* aggregated score of all factors
* rating report explaining the final score or aggregated score
* specific information, please explain
* data accompanying rating
* other aspects

**Q16. If you responded ‘other aspects’ to the previous question, please explain why?**

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| --- |
| * While different providers’ scores on the same company may diverge, transparency in data sourcing and methodologies is essential for users.   + Users need clarity on what ESG ratings are measuring – whether it is ESG risk exposure, governance practices, level of disclosure, physical or transition risks, etc.   + Where transparency is insufficient, users often choose to purchase raw data instead.   + It is also important that a change to an ESG score is provided to all market participants in a consistent and transparent way. Where certain market participants are not aware of a change (or do not have access) to an ESG ratings’ change, this can lead to distortion within the market. * Timeliness, accuracy and reliability of ESG ratings is also essential for a fair and effective market, especially when ratings are employed to meet regulatory requirements or for the provision of loans - and thus have an impact on the cost for companies to raise capital.   + Furthermore, timeliness of ESG ratings requires ESG ratings to be updated, to reflect current information, on both a regular and reasonably frequent basis. * Users value forward-looking metrics and strategic considerations on rated companies’ transition towards a sustainable business above backward-looking information. * A rating report explaining the final score or aggregated score provides invaluable contextual information for users to identify the most relevant information and understand the most appropriate use for each rating. * Users would value a more granular categorisation of companies into different sectors. Ratings often cluster companies into broad sectors without providing granular analysis. * Users’ choice of providers is also influenced by the coverage of rated companies, usually low for private ones, as well as the resources that the provider is endowed with. |

**Q17. To what degree to 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)?**

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**Section 2: Questions for companies subject to ratings**

**Q1. Do you have access to ESG ratings of your own company?**

* Yes
* No
* No opinion

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| Yes, we do have access to ESG ratings of our company. However, we do not always have comprehensive access, or the level of access we would ideally like, due to insufficient transparency in the ratings and their methodologies and limits to engagement from analysts. Interactions between ESG rating providers and covered entities would benefit greatly from improved governance processes. A more systematic engagement is needed in order to improve the reliability of ratings and the orderly functioning of the market.  In particular, since ESG ratings are often unsolicited, companies may be unaware that they are rated by certain ESG rating providers and/or are not notified when changes are made to their rating.  Rated companies should (i) be given notice of the preparation of unsolicited ratings and (ii) be offered sufficient time to provide precise data and relevant, contextual information for the purpose of such rating. Ratings should then be reviewed and updated regularly, with similar levels of engagement. It would be beneficial for rated entities to be provided with advance notice of the timing and frequency of such reviews to facilitate effective and efficient engagement. Rated entities should also be informed of rating changes, preferably in advance with analysts made available to discuss reports. To facilitate this, an exemption should be provided enabling delayed disclosure of rating changes where this is price sensitive information for the purposes of the Market Abuse Regulation.  ESG rating providers should also improve the communication process related to changes to ESG rating methodologies and should both inform and consult the market about those changes to methodologies.  We also note that ratings from certain providers, while updated annually, only allow issuers to review their data every other year (e.g. Moody’s ESG Solutions, ISS ESG Corporate Rating) while others (e.g. FTSE Russell) have an annual review period but update their rating on a quarterly basis based on public information without direct input from the rated company. This risks not only a lack of transparency, but also potentially lower quality ratings for both the user of such rating and the rated company, due to the inability of the rated entity to provide supplementary data or commentary via engagement with the provider and its analysts.  Another important challenge with the provision of feedback to the ESG rating providers is that on many occasions it is not clear what information they are looking for, nor how the feedback we provide is taken into account.  In cases where we are trying correct what we believe to be inaccurate, very little feedback is shared by the ESG ratings agencies as to why they may not take account of information provided by us on a particular matter. There are also significant delays between us providing feedback and this feedback being taken into account or us receiving a response. We believe this is a missed opportunity for meaningful engagement and data collection or analysis.  We also note that, in some cases, data is collected through a federated model of data scrapers and assessed by non-specialists with a limited understanding of the ESG information they review or the financial services sector more broadly.  In the case of ‘controversies’, we note that ESG rating agencies at times rely on early stage litigation, and/or partial reports of the status of cases. In our view, the assessment of controversies should be based on outcomes – court awards/decisions/findings or regulatory findings – where the entity’s position has been considered and tested by an independent third party, rather than media speculation. Particularly for class actions, the information used tends to be one-sided and does not take into account the position of the entity.  Furthermore, ‘controversies’ can have a lasting impact on ESG ratings even after they are concluded. In some cases, this can be several years. We note that the same event is often classified into multiple separate controversies based on the new coverage which then disproportionately impacts ESG scores. New media reportage of a past event can also restart the clock on how long a controversy stays on a rated companies report, which again is not based in any tangible new award, decision or finding. |

**Q2. To what degree do you use ESG ratings to assess the way you manage sustainability risks and opportunities and your impact on the outside world, on a scale from 1 (not determinant) to 10 (determinant)?**

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**Q3. If you do not use ratings, what do you use to assess the way you manage sustainability risks and opportunities and your impact on the outside world?**

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| We use ESG ratings as inputs into our ESG disclosure strategy. However, they are only one aspect of how we manage sustainability risks and opportunities and our impact on the outside world. Other important considerations include stakeholder and investor engagement, ESG regulations, global frameworks (e.g. the Paris Agreement, the SDGs), reporting frameworks (SASB, PRB, GRI), etc.  Additionally, our approach to reducing our financed emissions (and therefore measuring our impact on the outside world) is underpinned by BlueTrack™, a methodology we have developed for measuring our financed emissions and tracking them at a portfolio level against the goals of the Paris Agreement. |

**Q4. Does this vary between individual E, S and G factors?**

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| Yes. We have specific sustainability statements and policy positions as well as ESG metrics and targets for E, S and G factors. For example, we have statements governing environmental exclusions for our financing including Climate Change, Forestry and Agricultural Commodities and World Heritage Sites and Ramsar Wetlands. On the social side, we have policy positions on the Defence Sector, Human Rights and Modern Slavery. |

**Q5. Do you provide information on ESG ratings you have received in any of your public documents?**

* Yes
* No
* No opinion

**Q6. If you responded yes to the previous question, please specify where you disclose this information:**

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| Public disclosures of our ESG ratings include:   * Barclays PLC Annual Report 2021, pg. 102 (<https://home.barclays/content/dam/home-barclays/documents/investor-relations/reports-and-events/annual-reports/2021/Barclays-PLC-Annual-Report-2021.pdf>) * Website (<https://home.barclays/sustainability/esg-resource-hub/reporting-and-disclosures/esg-ratings-and-benchmarks/>) * Investor materials (<https://home.barclays/content/dam/home-barclays/documents/investor-relations/ResultAnnouncements/2021FYResults/20220223-Barclays-FY21-ESG-Investor-Presentation.pdf>) |

**Section 3: Questions for all respondents**

**Q1. Do you consider that the market of ESG ratings will continue to grow?**

* Yes
* No
* No opinion

**Q2. 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)?**

|  |  |
| --- | --- |
| 10 | Growth in demand from investors in ratings of companies for their investment decisions |
| 6 | Growth in demand from companies in ratings including on rating future strategies |
| 8 | Further standardisation of info disclosed by companies and other market participants |
| 7 | Other |

**Q3. If you responded ‘other’ to the previous question, please specify the other reasons you see for this market to continue to grow**

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| * Growth in demand from both investors and companies to specify transition plans. * Growth in demand from financial institutions driven by regulation and increased reliance on third parties to meet disclosure requirements where companies are not required to disclose relevant sustainability information. * Growth in structured investment products based on ESG scores. |

**Q4. Are you considering to use more ESG ratings in the future?**

* Yes, to a large degree
* Yes, to some degree
* No
* No opinion

**Q5. If you responded ‘yes’ to the previous question, please explain why**

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**Q6. If you responded ‘no’ to the previous question, please explain why**

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| At this moment in time we do not have a strong opinion as to whether we will use more ESG ratings in the future. However, in line with the factors articulated within the question “*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)?*”, we expect the market to continue to grow. |

**Q7. Do you mostly use ESG ratings from bigger or larger market players?**

* Exclusively from large market players
* Mostly from larger market players
* Mixed
* Mostly from smaller market players
* Exclusively from smaller market players
* Not applicable

**Q8. If you use mostly or exclusively ratings from large ESG rating providers, what are the main reasons for this?**

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| Larger ESG rating providers tend to be able to provide a broader coverage in terms of scope and global servicing. They also tend to be recognised as credible providers due to their access to greater expertise and resource.  Users value in a ESG Rating provider the quality of its methodology and the size of its database. Large market players, already established in the market, are seen to be well placed to provide quality assessment and data.  In addition, as many users source ratings from the same provider, large ESG rating providers allow for the possibility to benchmark and compare different methodologies in the absence of global standards for the industry. |

**Q9. Do you consider there is a sufficient offer of ESG ratings from providers located in the European Union?**

* Yes
* No
* No opinion

**Q10. If you responded ‘yes’ to the previous question, please explain why**

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**Q11. If you responded ‘no’ to the previous question, please explain why**

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**Q12. Finally, do you use other types of ESG assessment tools than ESG ratings (e.g. controversy screening, rankings, qualitative assessments, etc.)?**

* Yes
* No

**Q13. 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?**

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| We use a number of tools which are integral to the due diligence activity we undertake on clients in-scope of our policies and also in our investment screening. These would include the controversial weapons reports from MSCI & Sustainalytics as well as adverse media searches utilising such tools as Rep Risk, Factiva, Curation, and Google. |

**Q14. Do you believe that due diligences carried out by users of ESG research are sufficient to ensure an acceptable level of quality?**

* Yes
* No

**Q15. If you replied ‘no’ to the previous question, would you see merit in refining the current definition of research under** [**Directive 2014/65/EU1**](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0065)**?**

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| Whilst we do not believe that due diligence carried out by users of ESG research should be seen as a substitute for more formal regulation or oversight, we are not certain that amendments to the MiFID II definition of “research” is the best place to resolve this issue. It would be helpful if more information could be provided on what type of refinements the EC are envisaging for this question. |

**Q16. 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?**

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| No. We have listed below a number of risks associated with consumer protection, transparency, and the potential for greenwashing, that have to date prevented ESG research products from reaching a sufficient level of maturity and comparability. As ESG investing becomes more common, it is our view that ESG ratings could pose a risk to orderly markets, financial stability and investor protection in the EU, with distortions in the capital allocation process, due to lack of clarity in the ESG ratings and data products.   * As consumers increasingly look to invest sustainably, the risk of misselling ESG products is becoming substantial. Poorly sourced ratings and ESG data increases information asymmetries and decreases the transparency of a growing part of the investment market. * Academic studies have shown that ESG ratings from different providers disagree substantially (see [https://papers.ssrn.com/sol3/papers.cfm?abstract\_id=3438533](https://eur01.safelinks.protection.outlook.com/?url=https%3A%2F%2Fpapers.ssrn.com%2Fsol3%2Fpapers.cfm%3Fabstract_id%3D3438533&data=05%7C01%7Craj.sidhu%40barclays.com%7C722f5fa92d644fbefa8e08da3f1c19f8%7Cc4b62f1d01e04107a0cc5ac886858b23%7C0%7C0%7C637891687167031894%7CUnknown%7CTWFpbGZsb3d8eyJWIjoiMC4wLjAwMDAiLCJQIjoiV2luMzIiLCJBTiI6Ik1haWwiLCJXVCI6Mn0%3D%7C3000%7C%7C%7C&sdata=HsWARNaPUnPW7eWyY6rk92I%2BkwDa0U9D8EOp05ZmPwM%3D&reserved=0)). As such, the current lower correlation between the ESG ratings of different providers can pose risks in certain use cases as users may tactically select the provider that supplies the most advantageous rating. Additionally, this lack of low correlation creates confusion among clients and users. * Feedback from market participants mentions misclassification of businesses, inaccurate data on geographic location of company assets and recurring errors in annual reviews despite infrequent or irregular updates. Ratings may therefore not reflect the latest information and disclosures for protracted periods. * We observe a significant proportion of market participants using and relying on third-party ESG ratings without a robust understanding of their methodology and limitations. We find they are often implemented as absolute indicators of ESG, without due consideration to the subjective assessments (estimates, assumptions) they include. * As more products are created based on ESG ratings and data, there is an enhanced risk of market manipulation where ratings or data that can impact the price or performance of such products can be influenced by sources that are themselves open to manipulation or are speculative, such as for instance where media reporting could be driven by the planting of stories. * As there is a difference in business model at ESG ratings / data companies versus credit rating agencies, coverage can be varied and big names are sometimes omitted. An ESG rating agency may not have a commercial incentive to score a name (credit rating agencies are issuer funded, versus ESG scores/ratings agencies that are paid by licensees.). This also has consequences for smaller companies, and/or during the IPO process. * Communication of rating changes is problematic. There is no formal, timely, consistent communication of changes in ESG ratings (unlike credit ratings). This is problematic in the context of moving asset prices. We have tried but been unable to acquire historic data to track exact dates of changes in ESG ratings from a major provider (several months’ missing data for 2019). Changes in methodology are insufficiently transparent in particular as regards historic data, making it unreliable. |

## **Functioning of the ESG ratings market**

**Q1. How do you consider that the market of ESG ratings is functioning today?**

* Well
* Not well

**Please explain**

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| --- |
| Given the increasing importance and relevance of ESG ratings and data products, it is essential to ensure their transparency, comparability and reliability. We summarise the shortcomings in the ESG ratings market as follows:   1. ***Lack of transparency in methodologies***   The methodological approaches underlying ESG ratings and data products are very diverse. Each ESG rating provider makes different choices about which ESG factors to consider in their assessments and there is relatively large divergence between providers’ methodologies and metrics, as well as among the products and areas covered.  Providers also combine these metrics in different ways, applying different weighting and aggregation methodologies. These differences in methodologies result in low correlation and high divergence in ESG ratings and data products between providers, even where products are aiming to address the same objective, which negatively affects the reliability and comparability of the information.  In some cases, this lack of transparency may also lead to multiple ratings for the same company, with the possibility of a company being rated very highly by one provider, while getting a low rating from another.  Without sufficient methodological transparency, users are unable to determine the drivers behind why two providers’ ratings are different. This has the potential to cause significant market confusion for investors and other parties and could also increase opportunities for greenwashing or have other negative market impacts.  We particularly note that there is a lack of transparency on what a particular product is intended to measure (e.g. measuring ESG risk or sustainability impact), which also creates confusion among users.  There is also a lack of alignment in definitions and approaches which, together with the lack of clarity in the methodologies used, makes ratings and data difficult to compare.   1. ***Lack of transparency in data collection and lack of traceability***   Currently, there is no “standard” market practice for the manner in which ESG ratings and data products providers gather information about the entities that are the subject of these ratings or data products. This leads to a lack of transparency and reliability around the use of ESG data sources with providers using very diverse methodologies. For example, some providers use direct engagement with companies through questionnaires and others controversy screening from media sources. There is also subjectivity, especially with controversy type products.  The timeframe used for some assessments is not clear either, nor how up-to-date is the data being used. For example, on many occasions information is not disclosed as to whether the assessment is based on historic controversies or on future commitments.  Completeness of data is also problematic as gaps in disclosures from companies are filled by estimates and assumptions. Traceability of data sources and distinguishing disclosures from estimates in these cases is challenging.   1. ***Too little engagement with the corporate issuers***   One of the most significant sources for a number of providers is the information gained from entities that are the subject of ratings or data products, however we find that there is too little interaction with these entities with less than half of the data, on average, obtained directly from the company covered.  Some ESG ratings and data products providers only engage with the entities that are the subject of the ratings at a late stage of the rating process. Data is frequently collected from public sources including company reports and, for controversy screening, from the media. These sources may be inaccurate or taken out of context. Conclusions based on information collected from the media may be misleading and/or outdated.   1. ***Need for adequate resourcing and expert analysts***   In our experience, ESG rating analysts often do not have sufficient knowledge and familiarity with the corporate issuer, sometimes dedicating very little time to their analysis. In other cases, the lack of resources can lead to the use of over-simplified tools with little human analysis.   1. ***Concerns around conflicts of interests***   Some ESG ratings and data products providers also offer other ESG products and services. There are concerns about the management of conflicts of interest where the ESG ratings and data products provider, or an entity closely associated with the provider, performs consulting services for companies that are the subject of these ESG ratings or data products.   1. ***Large dispersion between providers***   As frequently remarked, there is a very low correlation between the ESG ratings from different providers. |

**Q2. 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)?**

|  |  |
| --- | --- |
| 10 | Lack of transparency on the operations of the providers |
| 10 | Lack of transparency on the methodologies used by the providers |
| 8 | Lack of clear explanation of what individual ESG ratings measure |
| 8 | Lack of common definition of ESG ratings |
| 10 | Variety of terminologies used for the same products |
| 10 | Lack of comparability between the products offered |
| 10 | Lack of reliability of the ratings |
| 8 | Potential conflicts of interests |
| 10 | Lack of supervision and enforcement over the functioning of this market |
| 10 | Other |

**Q3. If you responded ‘other’ to the previous question, please explain which ones:**

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| --- |
| Please see our response to the question ‘*How do you consider that the market of ESG ratings is functioning today?*’ with respect to the need for adequate resourcing and expert analysts, as well as too little engagement with the corporate issuers.  Additionally, there is a lack of clarity on the reliance of estimates and external data. This is compounded by a lack of robustness of some of the external data sources used (e.g. controversy screening). |

**Q4. What do you think of the quality of the ratings offered on a scale from 1 (very poor) to 10 (very good)?**

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| 3 |

**Please explain why:**

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| --- |
| Please see our response to the question ‘*How do you consider that the market of ESG ratings is functioning today?*’  In short, the quality of the ratings offered is defined by their reliability and comparability, which is negatively affected by the lack of transparency on providers’ sources and methodologies, as well as the lack of appropriate engagement with rated companies. |

**Q5. If you responded ‘very poor’ or ‘poor’ to the previous question, to what degree do you consider that this affects your trust in the products that are offered, on a scale from 1 (no affect) to 10 (affects very much)?**

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| 8 |

**Please explain why**

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| The quality of ESG ratings and of the underlying analysis varies widely between providers. Please see our response to the question ‘*How do you consider that the market of ESG ratings is functioning today?*’ for further detail.  In short, the quality of the ratings offered is defined by their reliability and comparability, which is negatively affected by the lack of transparency on providers’ sources and methodologies, as well as the lack of appropriate engagement with rated companies. |

**Q6. Do you consider that there are any significant biases with the methodology used by the providers?**

* Yes
* No
* No opinion

**Q7. If you responded yes to the previous question, please specify the biases**

* Biases based on the size of the company rated
* Biases based on the location of the company
* Other biases

**Q8. If you responded ‘other biases’ to the previous question, please explain which ones**

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| --- |
| We consider that there is a risk that companies will gravitate towards certain ESG rating providers that are likely to provide them a higher score. These are down to several factors, including: methodologies; expertise; and geographical location of the rating companies. |

**Q9. Do you think the current level of correlation between ratings assessing the same sustainability aspects is adequate?**

* Yes
* No
* No opinion

**Q10. To what degree do you consider that a low level of correlation between various types of ESG ratings can cause problems for your business and investment decision, as an investor or a rated company, on a scale from 1 (no problem) to 10 (significant problem)?**

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| 8 |

**Q11. 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)**

|  |  |
| --- | --- |
| 10 | Lack of transparency on the methodology and objectives of the respective ratings |
| 10 | The providers do not communicate and disclose the relevant underlying information |
| 7 | The providers use very different methodologies |
| 7 | ESG ratings have different objectives (they assess different sustainability aspects) |
| 8 | Other issue(s) |

**Q12. If you responded ‘other issue’ in the previous question, please explain which one(s)**

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| --- |
| Please see our response to the question ‘*How do you consider that the market of ESG ratings is functioning today?***’** |

**Q13. 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
* Rather negative

**Please explain your response to the previous question:**

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| --- |
| The lack of clarity as to what different ESG ratings measure (what sustainability aspects they focus on) is not well-understood in the market in part due to the lack of transparency of methodologies on behalf of the rating agencies. |

**Q14. 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)?**

|  |
| --- |
| 8 |

**Q15. 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
* Where providers charge companies to see their own reports
* In the absence of separation of sales and analytical teams
* 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
* In the lack of public disclosure of the management of potential conflicts of interest
* Other conflict(s) of interest

**Q16. If you responded ‘other(s) conflicts of interest’ to the previous question, please specify the additional risks you see**

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| --- |
|  |

**Q17. 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)?**

|  |
| --- |
|  |

**Q18. What barriers do you see for smaller providers?**

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| --- |
|  |

**Q19. 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)?**

|  |
| --- |
|  |

**Q20. 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)?**

|  |
| --- |
| 3 |

**Q21. Do you consider that information on the fees charged by the providers is sufficiently transparent and clear?**

* Yes
* No
* No opinion

**Q22. If you responded ‘no’ to the previous question, please specify what you consider should be the minimum information to be disclosed**

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| --- |
| More transparency is required when it comes to costs and product offerings (especially scope and coverage). This information should be clearly communicated to potential clients to allow for fair comparisons of providers and products. |

## **EU intervention**

**Section 1: Need for an EU** **intervention**

**Q1. Taking into account your responses to the previous sections, do you consider that there is a need for an intervention at EU level to remedy the issues identified on the ESG rating market?**

* Yes
* No
* No opinion

**Please explain why:**

|  |
| --- |
| * As investors’ focus on ESG matters continues to increase and the markets require increasing volumes of data to comply with sustainability disclosures regulatory requirements, the use of environmental, social and governance (ESG) ratings are having an increasingly important impact on the operation of capital markets. As our response to the question ‘*How do you consider that the market of ESG ratings is functioning today?*’ sets out, regulatory intervention is required to correct the market failures that are increasingly causing distortions in the capital allocation process. * EU intervention should also address in the short-term the issues described, through guidelines on transparency and governance and by drawing common definitions and best practices. * Any measures should be developed in line with existing and upcoming sustainability disclosure requirements, and aim at improving the availability of reliable information. * Guidelines should be effective and proportionate, ensuring the sector can continue to innovate and evolve alongside the market’s understanding of sustainability issues. * Measure should not prevent smaller or boutique providers, including NGOs, investor initiatives and semi-commercial operators, from participating in the market. * It would be beneficial to expand ESMA’s remits and set up a registration and supervision regime for ESG ratings providers, similar to that in place for CRAs. * EU intervention should be coordinated with international bodies and, in particular, should be consistent with IOSCO’s [recommendations](https://www.iosco.org/library/pubdocs/pdf/IOSCOPD690.pdf) (https://www.iosco.org/library/pubdocs/pdf/IOSCOPD690.pdf) for securities markets regulators. We would additionally suggest that the European Commission works closely with other jurisdictions that are also considering intervention to avoid regulatory fragmentation. |

**Q2. 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

**Q3. 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,
* Improving transparency on the methodology used by the providers,
* Improving the reliability and comparability of ratings,
* Clarifying what is meant by and captured by ESG ratings, to differentiate from other tools and services,
* Clarifying objectives of different types of ESG ratings,
* Improving transparency on the fees charged by the providers,
* Avoiding potential conflicts of interests,
* Providing some supervision on the operations of these providers,
* Other measures (please specify).

**Q4. For each of the points you selected in the previous question, please explain what solutions and options you would consider appropriate**

|  |
| --- |
| We believe that the IOSCO recommendations (<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD690.pdf>) should form a starting point for any solutions. These include, but are not limited to:   * Improving transparency on the methodology used by the providers: providers should be asked to publish information on the methodology used for their ratings in line with common transparency guidelines. Providers should ensure transparency on the results of their materiality assessment for each sector and rated company, which metrics have been selected as relevant, and what weight has been attributed to each of these. Clearer guidance on the aims of ESG ratings and guidance on the scoring criteria will help increase knowledge of what is being rated and why. This will allow both rated companies and ratings users to understand what drives ESG scores. * Improving the reliability and comparability of ratings: providers should be asked to specify the sources of data and whether the information have been provided directly from rated companies, are based on estimates, or have been collected from public sources. Providers should also specify the objectives and intended use of their products, for instance whether the product is measuring ESG risk or sustainability impact. At the very least, there should be minimum standards in the accuracy of the collation of raw data. Further, we consider it would be preferable for ESG rating providers to make public the relative weight of the various indicators, the time span of the data used, and the impact of relevant events such as controversies on the scores. * Avoiding potential conflicts of interests: intervention could seek to introduce harmonised minimum disclosures on how providers identify and prevent potential conflicts of interest through their governance arrangements and enhanced transparency. For instance, by ensuring a clear separation among the functions or departments involved in consultancy services and the analysts evaluating the companies. * Providing some supervision on the operations of these providers: expanding ESMA’s remits and set up a registration and supervision regime for ESG ratings providers. |

**Q5. If you responded ‘other’ to the previous question, please specify the other elements the intervention should focus on**

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| --- |
| * Fostering better governance and engagement with rated companies: EU intervention should draw best practices on the governance around the provision of ESG ratings.   Proportionate rules should spell out how rating providers engage with rated companies, with the aim to collect data directly, where possible, and complement scores with any relevant contextual information on the rated company’s business and outlook.  Rules should also ensure that rated companies are given notice of unsolicited ratings being prepared or existing ratings being updated, while being offered sufficient time to provide precise data and relevant contextual information.   * Further, the involvement of the rated entities in the rating process should be strengthened and providers should ensure there are appropriate avenues for rated companies to review ratings before these are published. The opportunity for rated companies to respond and be given notice of a change to rating is essential and we believe this should be standardised across the ESG ratings market. As highlighted in our response, ESG ratings have increasing importance in driving financial flows / external reputation, making the need for (i) a notice requirement and (ii) the opportunity to respond increasingly important. * Communication of changes in ratings. From a user’s perspective, in cases where an ESG rating score is changed for a company, we consider that EU intervention should look to apply transparency and communication similar to those that are mandated for CRA rating changes. If users / market participants are not reasonably notified of a change in ESG rating, this can lead to distortions within the market. |

**Q6. 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
* No
* No opinion

**Please explain why**:

|  |
| --- |
| * We find it would be beneficial to expand ESMA’s remits and set up a registration and supervision regime for ESG ratings providers, similar to that in place for CRAs. * Registration is necessary for external ratings to be recognized in the wider EU legal framework (just as CRAs’ credit ratings are recognized in the CRR for instance). * Authorisation or registration is a prerequisite for supervision. We consider EU supervision by ESMA is necessary to ensure enforcement of EU requirements. * Given the number of ESG ratings providers currently in the market, it would be useful to know which are “authorised” to ensure credibility when choosing a provider. |

**Q7. 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
* No opinion

**Please explain why**

|  |
| --- |
| To the extent that the EU is extending any authorisation companies to non-EU companies, this should be done in a proportionate manner where there is primary location of liquidity*.* |

**Q8. Do you consider that there should be some minimum disclosure requirements in relation to methodologies used by ESG rating providers?**

* Yes
* No
* No opinion

**Please explain why**

|  |
| --- |
| * The introduction of minimum disclosure requirements in relation to methodologies used by ESG rating providers should be the prime focus of EU intervention. Transparency is needed to improve trust in, and reliability of, ESG ratings. * Providers should be asked to publish information on the sources of data and the methodology used for their ratings in line with common transparency guidelines. * Providers should ensure transparency on the results of their materiality assessment for each sector and rated company, which metrics have been selected as relevant, and what weight has been attributed to each of these. * Providers should disclose the policies they adopt to address conflict of interest. * Additional key information needed include the following:   + The main sources of data used;   + The procedure to ensure the quality of the analysis and ratings, and the qualification of analysts (including knowledge of the local ecosystem);   + The integration of national specificities / local ecosystem and rated company specificities into the analysis, including how it is taken into account;   + The engagement process with the rated company. |

**Q9. Do you consider that the providers should be using standardised templates for disclosing information on their methodology?**

* Yes
* No
* No opinion

**Please explain:**

|  |
| --- |
| * Rating providers should disclose their full methodologies, including weightings and scoring criteria. Using the same templates is less important than transparency of approach. * That being said, we consider that a voluntary, standardised template, part of a broader set of guidelines and based on a review of best practices, is the preferred option to enhance transparency and comparability while offering flexibility and maintaining a level-playing field. * We would note that these voluntary standardised templates should interoperate with the proposed European Single Access Point (ESAP). This would further improve access to ESG funding, broaden investment opportunities for retail investors, and better integrate capital markets. |

**Q10. Do you consider that the rules should be tailored to the size of the provider and hence have smaller providers subject to a lighter regime?**

* Yes
* No
* No opinion

**Q11. If you responded yes to the previous question, please specify what metric you consider should be used to differentiate between providers:**

* Total revenue
* Revenue from ESG ratings
* Number of employees
* Other metric(s)
* in the case of providers located outside the EU and not providing services to EU investors but rating EU companies/financial instruments – percentage of EU companies/financial products rated

**Q12. If you responded ‘other metric(s)’ please explain which one(s):**

|  |
| --- |
|  |

**Q13. 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
* No opinion

**Q14. If you responded yes to the previous question, please specify what metric you consider should be used to differentiate between providers:**

* Percentage of EU companies/financial products rated
* Other metric(s)

**Q15. If you responded ‘other metric(s)’ please explain which one(s):**

|  |
| --- |
| Whichever threshold used re ‘other metric(s)’ should be proportionate and should not deter innovation. |

# **PART B – INCORPORATION OF ESG FACTORS IN CREDIT RATINGS**

**Section 1: Questions to users of credit ratings**

**Q1. Do you use credit ratings for investment decisions?**

* Yes, as a starting point for internal analysis
* Yes, as one of many sources of information that influence investment decisions
* Yes, as a decisive input into an investment decision
* No
* Other

**Q2. If you use credit ratings for other purposes, please explain:**

|  |
| --- |
|  |

**Q3. Do you use credit ratings for regulatory purposes (e.g. stemming from the** [**Capital Requirements Regulation**](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32013R0575) **or** [**Solvency II**](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32009L0138)**)?**

* Yes
* No
* These requirements don’t apply to me

**Q4. Is it important for you to understand to what extent individual credit rating actions have been influenced by sustainability factors?**

* Not important at all
* Slightly important
* Important
* Very important
* No opinion

**Q5. Do you find information about the extent to which CRAs methodologies or the rating process incorporate sustainability factors sufficiently well disclosed?**

* Yes
* No
* No opinion

**Please explain**

|  |
| --- |
| We consider that it is beneficial to understand the extent to which rating actions have been driven by sustainability factors. We are aware of instances that credit rating agencies have not been able to share historic rating changes that were driven by ESG factors. That being said, we welcome that the majority of credit rating agencies produce consultations and announce how changes are being made to the way that they take into consideration ESG factors. This is in contrast to ESG Rating Agencies.  However, we believe it is important to remember that the function of a credit rating agency is to only incorporate factors that could impact the ability of a company to fulfil its debt obligations. It should therefore not be compulsory for credit rating agencies to consider all ESG factors for all issuers. Nonetheless, it should be clear what they are considering. |

**Q6. Where do you look currently for the information on how ESG factors impact the credit rating? (multiple choice)**

* Press release accompanying credit ratings
* Additional analysis and reports available to subscribers
* Additional information materials available publicly
* Description of methodologies or rating process for specific asset classes, sectors or types of entities
* Frameworks or documents describing general approach to incorporation of ESG factors in credit rating process
* I don’t know where to find such information
* Other

**Q7. If you responded ‘other’ please explain where:**

|  |
| --- |
| Other includes credit rating agency websites. |

**Q8. Does the level of disclosure differ depending on individual CRAs?**

* Yes
* No
* No opinion

**Q9. If you answered yes to the previous question, please explain the differences in the level of disclosure:**

|  |
| --- |
|  |

**Q10. What are the trends on the market in relation to disclosure of information as to which credit ratings actions have been influenced by sustainability factors? (multiple choice)**

* The level of disclosure has improved sufficiently since the entry into effect of ESMA guidelines (April 2020)
* In general the level of disclosure has improved sufficiently although some CRAs are lagging behind
* The overall level of disclosure is insufficient although some CRAs have sufficiently improved
* The extent to which CRAs incorporate ESG factors in credit ratings depends on the asset classes methodologies and the importance assigned to the given factor by a CRA’s methodology. In addition, some CRAs have developed overall frameworks explaining how they incorporate ESG factors in credit ratings across asset classes, some publish reports reviewing past credit rating actions or specific sections accompanying credit rating actions.

**Q11. In your opinion, what are trends in the relation to the incorporation of ESG factors in the credit rating process and methodologies?**

* CRAs have sufficiently improved the incorporation of ESG factors in their methodologies and rating process,
* In general CRAs have sufficiently improved the incorporation of ESG factors in credit ratings although some CRAs are lagging behind
* In general the development is insufficient although some CRAs have improved the incorporation of ESG factors in their methodologies and rating process,
* CRAs have insufficiently improved the incorporation of ESG factors in their methodologies and rating process

**Section 2. Questions on the need for EU intervention (all respondents)**

**Q1. Do you consider that the current trends in the market are sufficient to ensure that CRAs incorporate relevant ESG factors in credit ratings?**

* Yes
* No
* No opinion

**Q2. Do you consider that the current trends in the market and application of ESMA guidelines on disclosure applicable to CRAs are sufficient to ensure understanding among users as to how ESG factors influence credit ratings?**

* Yes
* No
* No opinion

**Q3. If you responded ‘no’ to the previous questions, what type of intervention would you consider necessary? (multiple choice)**

* Further detailing of ESMA guidelines on the disclosure of ESG factors in credit ratings
* Further supervisory actions by ESMA
* Legislative intervention.
* While improvements are insufficient, we do not see further scope for EU intervention
* Other, please specify

**Q4. If you responded ‘other’ to the previous question, please specify the other type of intervention you consider necessary:**

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| --- |
|  |

**Q5. Regarding the possible regulatory intervention, what type of requirements do you find relevant? (multiple choice)**

* Press releases: introduce mandatory requirements mirroring the provision of ESMA guidance on the disclosure ESG factors in credit ratings
* Press releases: in addition to the previous option require CRAs to publish information not only about the impact of ESG factors on credit ratings, but also the lack of it,
* Methodologies: require CRAs to explain the relevance of ESG factors in methodologies,
* Methodologies: require CRAs to take into account ESG factors where relevant,
* Other.

**Q6. If you responded other, please explain:**

|  |
| --- |
|  |

**Q7. What kind of risks or merits of the EU intervention do you see?**

* Provide further clarity on the impact of ESG factors on the creditworthiness of creditors and financial instruments
* More coherent approach of CRAs to the incorporation of ESG factors into credit ratings
* Concerns about too much prominence given to ESG factors
* Others

**Q8. If you responded ’others’, please explain:**

|  |
| --- |
|  |

**Q9. What would be the consequences of the lack of the EU intervention? (multiple choice)**

* Market trends are sufficient to meet investors demands for information on the impact of ESG factors on credit ratings
* CRAs will respond to market pressure and ensure the incorporation of ESG factors in credit ratings
* The existing gap between approaches of CRAs to the incorporation of ESG factors in credit ratings will grow
* Concerns about the insufficient incorporation of ESG factors in credit ratings lack of understanding among investors why certain credit rating actions are not impacted by ESG factors

1. https://www.iosco.org/library/pubdocs/pdf/IOSCOPD690.pdf [↑](#footnote-ref-2)