

By e-mail
European Commission
Directorate General for Financial Stability, Financial
Services and Capital Markets Union
Mr John Berrigan
Brussels
BELGIUM

Date	3 June 2022
Our reference	JnDf-22061091
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Subject	AFM response to the public consultation on the functioning of the ESG ratings market in the European Union and on the consideration of ESG factors in credit ratings

Dear Sir,

The Dutch Authority for the financial markets (AFM) supports the European Commission's initiative to consult the market and relevant stakeholders in order to gain a better insight on the functioning of the market for ESG ratings. The AFM is grateful for the opportunity to share our views and experiences and provide possible policy solutions. The AFM has responded through the online questionnaire on the website of the European Commission. In this letter, the AFM wishes to highlight the most important points made in the online questionnaire. For reasons of transparency, the AFM will publish this letter on its website.

The AFM is an independent market conduct authority that supervises the conduct of the entire financial market sector in the Netherlands: savings, investment, insurance, loans, pensions, capital markets, asset management, public accountants and (non-) financial reporting. The AFM is committed to promoting fair and transparent financial markets. The AFM is also a member of various European bodies and committees, among which the European Securities Markets Authority (ESMA).

The consultation covers a variety of topics pertaining to the functioning of the ESG ratings market in the European Union and is directed at a wide range of parties. In this letter, the AFM wants to highlight specific issues that are of particular importance to the AFM. Issues that we believe are indispensable to the well-functioning of the ESG ratings market. These issues were previously highlighted in the AMF-AFM position paper named 'Call for a European Regulation for the provision of ESG data, ratings, and related services'¹.

Annex 1 to this letter contains all answers the AFM has provided in response to questions from the consultation document.

¹ <https://www.afm.nl/~profmedia/files/rapporten/2020/amf-afm-paper-call-european-regulation-esg-data-ratings.pdf?la=nl-NL>

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A. Ensuring transparency concerning methodologies and underlying data of ESG ratings²

Transparency about methodologies of ESG ratings is key. At the moment, ESG ratings are not uniform and can involve different concepts. As a result, correlation between ESG ratings of different providers is quite low. The differences between these ratings can be the result of different methodological choices made by providers on which concepts to embrace, how to measure these concepts and how to weigh all the underlying indicators in a final score. The variety in ESG-rating methodologies reflects the innovative character of services in this market as well as varying client needs and demands. Consequently, the AFM is of the view that transparency on these methodologies in an understandable way should be required, in order to ensure investors are able to use these ratings and related data services to guide their investment decisions.

The focus should therefore be on realizing transparency on the underlying methodological choices. This level of transparency given by providers of ESG data and services over their methodologies differs and often appears to be insufficient. The stake for users is threefold: to determine whether a given ESG rating matches their own interpretation of ESG, to assess the quality and robustness of ratings, and to make appropriate investment decisions. Transparency requirements on methodologies will help increase comparability and understanding of ESG ratings by users.

As a result of upcoming European legislation, such as the CSRD and the development of sustainability reporting standards, relevant high-quality corporate ESG information will become more readily available, which will aid the standardization of underlying data. Forward looking, as the ESG rating market evolves and standardization and comparability of underlying data metrics increase, the AFM hopes that market standardization of methodologies for ESG ratings with similar objectives will emerge, to further foster understandability and comparability for users.

Next to methodologies, it is important that providers of ESG ratings, data, and related services clarify the sources of the information they collect, as well as the proportion of estimates used and how those estimates have been calculated. ESG data is not strictly defined and data gaps are common. Methodological decisions on data sourcing and how providers deal with missing data influence the final ratings, scorings and related data services. Therefore, transparency regarding these choices is essential for users.

² We also refer to our explanatory remarks in our answers to questions 35, 40, 42, 44, 53, 57, 68, 78, 80 of the consultation document.

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B. Specific requirements in terms of governance and management of conflicts of interest should be adopted³

Specific requirements on internal control and governance should be laid down to ensure reliability and quality of the services provided and proper management of conflicts of interest. Since there are no formal requirements regarding governance of ESG service and product providers, users cannot always trust that certain quality and reliability safeguards are in place. Special attention is warranted for potential conflicts of interest. The strong development in demand for ESG products and services and the high innovation capacity of providers bring risks of conflicts of interest. Providers of ESG ratings may play different roles, such as consultant, data provider or rating agency, and represent different interests. Therefore, it is important that they manage and avoid potential conflicts of interest and ensure an appropriate level of market transparency. Through the establishment of appropriate and effective organizational and administrative arrangements, these conflicts of interest can be identified and eliminated or managed.

C. The scope of the regulation should not be limited to ESG ratings and recognize the diversity and innovative quality of ESG-related products and services, including data provision⁴

Next to ESG ratings, there is a variety of ESG-related services and products available in the market. The AFM believes that limiting the scope of regulation to ESG ratings would create a high risk of circumvention. Instead, the scope of regulation should be aligned with the innovation in, and diversity of, the products offered and the impact of those services in the market. Therefore, the AFM is of the opinion that the scope should cover a wider scope of ESG products and services, especially with regard to ESG data processing, and not be limited to ESG ratings only. Examples include: screening services, ESG scores, GHG data, controversies research, ESG indices, and taxonomy related products.

Particularly, the provision of ESG data needs to be within the scope of regulation. Underlying data is at the very root of all ESG services and products, and rarely based on raw-data only. Transparency on the methodologies of data processing, and in particular the origination of the data, is essential for investors to ensure investors can apply due diligence on the services provided.

As a result, the AFM believes that the scope should cover the diversity of ESG-related products, services - including ESG ratings - and data provision.

³ We also refer to our explanatory remarks in our answers to questions 39, 42, 58, 68, 78 of the consultation document.

⁴ We also refer to our explanatory remarks in our answers to questions 39, 68, 71 of the consultation document.

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D. Supervision should be organised at the European level to ensure harmonized application and supervision⁵

In the case of any legislative intervention, which the AFM supports, and in order to ensure a harmonized application of rules and uniform supervision within the EU, the AFM is of the opinion that supervision should be placed at centralized European level, similar to supervision of credit rating agencies and trade repositories. Therefore, ESMA should be entrusted with the authorisation and supervision of providers of ESG ratings, data, and related services. The AFM is of the view that this is preferable to supervision by national authorities, as providers and clients are usually active across borders, and a limited number of large multinational undertakings dominate this market. This would not only ensure a harmonized approach, but also a concentration of expertise at the right level.

Lastly, in order to safeguard the development and innovation of start-ups and smaller local providers, the AFM emphasizes the need for proportionality when introducing a regulatory and supervisory regime, on the basis of size and revenue of the providers of ESG ratings, data and related services.

In conclusion

The AFM would welcome the opportunity to discuss further the issues raised in our responses to the questions in the consultation

Yours sincerely,
The Dutch Authority for the Financial Markets



Laura van Geest
Chair of the Executive Board



Hanzo van Beusekom
Member of the Executive Board

⁵ We also refer to our explanatory remarks in our answers to questions 42, 68, 74, 103 of the consultation document.