

## BVI<sup>1</sup> position paper on 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"

### PART A – ESG RATINGS

#### I. Use of ESG ratings and dynamics of the market

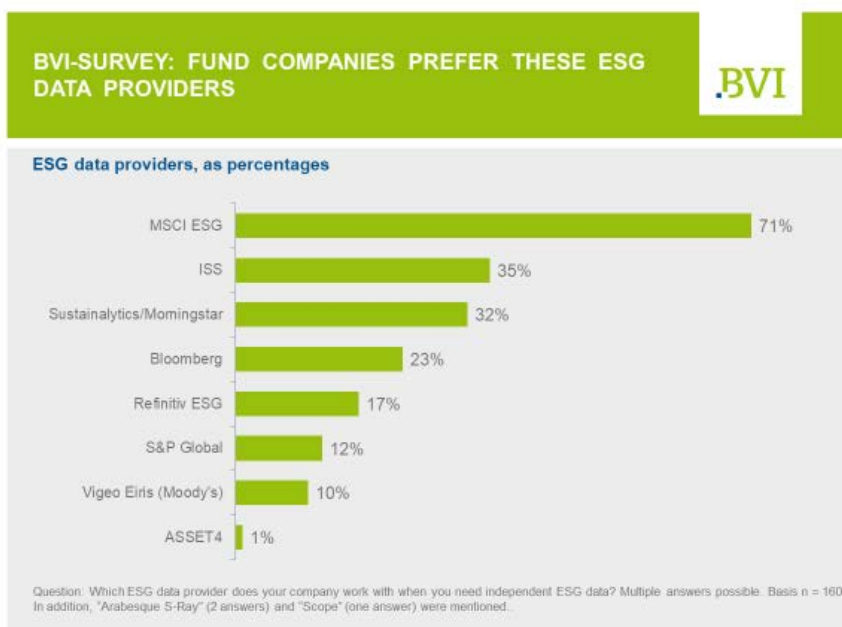
##### Questions for investors, asset managers and benchmark administrators

###### Do you use ESG ratings?

- ☒ Yes, very much
- ☐ Yes, a little
- ☐ No

###### Please explain:

The most common data types used by German asset managers are ESG ratings followed by sustainability labels, benchmarks and standards.



<sup>1</sup> BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset Managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 116 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 28%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit [www.bvi.de/en](http://www.bvi.de/en).



**Which type of ESG ratings do you use?**

**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
- ☐ Others

**ESG ratings providing an opinion investment funds:**

- ☒ exposure to and management of ESG risks
- ☒ impact on the society and environment
- ☒ ESG characteristics
- ☒ Other specialised ratings
- ☐ None
- ☐ Not applicable

**Please specify to what other specialised ratings you refer:**

Asset managers use all available ESG rating providers for dealing with sustainability issues followed by sustainability labels, benchmarks, and standards. Most of them obtain data from more than one data source and process it within the framework of its own research.

Asset managers rely on ESG ratings and data from a user perspective and are not themselves usually subject to assessment by rating agencies or data product providers.

They use also ESG ratings in the marketing of their funds, such as FNG Siegel (Germany) or LuxFlag.

**To what degree do you use ESG ratings in investment or other financing decisions on the scale of from 1 to 10 (1- very little, 10 – decisive)?**

7 for funds with sustainability characteristics.

**Please explain your answer:**

Environmental, social, and governance (ESG) investing is a very broad field with many different investment approaches addressing various investment objectives. At a top level, we can break down ESG investing into three main investment approaches: ESG integration, in which the key objective is to



improve the risk-return characteristics of a portfolio; second, values-based investing, in which the investor seeks to align his portfolio with his norms and beliefs; third, impact-related investing, in which investors want to use their capital to trigger change for social or environmental purposes, for example, to accelerate the decarbonisation of the economy. All approaches need a wealth of ESG data and analytics. Moreover, all UCITS and AIF managers will be required by EU law from August 2022 to systematically incorporate sustainability risks into their investment processes, regardless of whether they pursue an ESG investment strategy or not. ESG Ratings are one source of data that could be used for evaluation.

In this context, it is important to understand that the concept of ESG risk is not a new stand-alone risk management process, but rather a specific sub-set of market risk. To put it differently: sustainability risk is market risk inherent in a portfolio due to sustainability factors attached to the underlying investments of the fund. Therefore, as it stands, sustainability risk in fund investments is in general not identified and measured separately from other risks. Rather, it is included into the exposure to other relevant risks or considered part of the price valuation of portfolio assets.

Illustrative example: an investment fund invests in shares of an oil company which shows no interest to engage in the development of alternative fuels. This is relevant in terms of sustainability risk, but also impacts the market value of the company's shares, thus potentially resulting in a market risk for sustainability reasons. Or a shopping centre in a real estate fund is in a flood endangered area which puts the valuation in danger because of increased flooding risk resulting from climate change.

However, approaches in the market for the measurement of sustainability risk other than Scope 1 to 3 in carbon emissions are not standardised and the quality of available data still needs improvement in particular with respect to comparability and reliability. Furthermore, data on long-term developments is still scarce. Identification of a specific exposure of a fund portfolio to sustainability risk is and will continue to be a challenging exercise.

Moreover, both AIFs and UCITS are required by EU regulation not to rely exclusively on ratings. Nevertheless, ESG ratings are an important input factor in internal management processes, not the least because of (regulated) investor requirements. In practice, ESG ratings are used in the allocation and management of assets in accordance with the investment strategy of the fund. Some members use weighted or average rating scores based on the available ratings of the issue or, if this information is lacking, the rating of the issuer/counterparty/deposit taker/guarantor of an issue.

Illustrative example for funds investing in securities: an ESG risk profile can be determined based on the ESG ratings of the individual securities. Depending on the data model and data provider, the ESG rating shows how well an issuer manages its relevant ESG risks compared to a peer group. Issuers with low risk and good management receive a higher rating compared to issuers that are exposed to higher risks or have weaker risk management. According to the ESG ratings of the respective weighting of the individual securities, an ESG rating can be aggregated at the fund level. Bank deposits and derivatives can be excluded from this. In general, a non-existent rating should be equated with a 'poor' rating. However, it needs to be borne in mind that the choice of the rating provider is determining the outcome as results of ESG ratings and rankings are much less correlated than the results of credit rating evaluations.

**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

**Please specify to what other type(s) of ESG ratings you refer in your answer:**

German asset management companies use all three types of ESG ratings mentioned above: overall ESG ratings, ratings of an individual Environmental, Social and Governance factors, and ratings of specific elements within the Environmental, Social and Governance factors. (The survey logic does not allow for multiple selections.)

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

- ☒ Yes
- ☐ No
- ☐ Not applicable

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

Our members use and receive other rating products, including but not limited to:

- “indicative ratings”,
- “scoring”,
- “bond indexes”,
- “portfolio assessment tools”,
- “credit assessments”,
- “rating assessments”,
- “assessments”,
- “fund ratings”,
- “data feeds” or
- “research” or other tools which may be used for a person’s or organisation’s own risk assessments (for example, quantitative models and enterprise risk solutions software)

**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?**

There is a need to monitor the developments. Competent Authorities and regulators should take into account the existing market practices in order to deal with conflicts of interests by disclosure of types of research received and the main counterparties. We believe that a uniform quality standard for the evaluation process for external ESG ratings is necessary. In this respect, market data providers who provide ESG ratings could also be regulated. Conflicts of interest of the data providers should be avoided and should be made transparent to the public. Changes in the methodologies should be made transparent to the users and consulted with the public at large.

However, paid data feeds are the primary source of rating information, given that our members need to deal with thousands or hundreds of thousands of rated securities, depending on their size and investment focus. Paid rating data feeds either direct or through market data distributors are, given the



limitations on licence- and fee-free use of either CRA or the ESMA-provided European Rating Platform data website usage, today the easiest way to get the ratings into our members' databases and onwards into fund portfolio management, risk management, investment controlling and regulatory reporting systems and applications. Data feeds provide up-to-date ratings coverage and allow fast information of rating changes and therefore the possibility to consider them on a timely basis in all applications and reports. Our members also rely on paid data because they need to be sure to receive high quality and complete data from the ("golden") source. The data quality also hinges on the requirements in the contracts between our member companies and the data providers, although the latter usually exclude liability for the underlying data collected by them. If our members would rely today on free (third party collected) ratings information, there would be no certainty on the completeness of the data and important information e.g., on the reasons for a specific rating action, could be missing. Our members would switch, if they could, to obtain the ratings data via a reliable public data feed. The European Single Access Point (ESAP), however, could be a third party reliable ("golden") source also of sustainability data as the ESAP is regulator-backed.

#### What are you using ESG ratings for?

- ☒ 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).

#### Please explain your answer:

ESG ratings are an input factor in internal management processes, not the least because of (regulated) investor requirements. In addition to the above-mentioned purposes, we can discern the following use cases for the use of ESG ratings within our membership:

Reporting to clients and supervisory agencies (regulatory reporting – RR): the FinDatEx [platform](#) provides the European ESG Template, the EET, which covers all sustainability data needs of fund distributors, funds of funds, as well as regulatory required fund information under the SFDR, MiFID II and IDD frameworks. It includes more than 600 data fields that will be fully operationalised for data delivery by end-2022. Most fund managers provide their banking and insurance investors with reports to help them to implement their regulatory reporting obligations under CRD/CRR and Solvency II. Such reports usually provide information on the respective portfolio, including individual ratings and/or CQS, as well as other aggregated data on a weekly, monthly, quarterly, or annual basis. In case of fund holdings reporting to insurance companies there is a standard industry template called 'TPT' made available by FinDatEx. The use of EET and all other FinDatEx templates is not compulsory, and they are provided to the industry free of charge and free of any intellectual property rights.

Ratings are included in investor reporting to inform them inter alia on the portfolios' risk structure. It should be stressed that portfolio holdings reporting covers only a specific number of rated issues or issuers and never the full rating universe. Therefore, it should be clear that only a limited amount of individual ratings/CQS is shared for information purposes with investors but never for commercially driven redistribution purposes.



**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?**

In practice, it regularly happens that management companies compile their own benchmarks (e.g., from various public indices or direct company / issue data) for various purposes (e.g. performance, risk management). However, they are not benchmark administrators within the meaning of the BMR as these internal indices are usually not made public. In rare cases asset managers (usually through a BMR registered group company) provide public indices.

In particular, a practice of so-called 'self-indexing' has emerged, whereby no external benchmark administrator is involved in the production of benchmarks in order to reduce index costs and – more importantly – to be able to offer 'customised indices' to institutional investors, which exactly correspond to investor demand and are therefore often not easy to map with existing commercial indices. For example, it was hardly possible because of licence restrictions by the index providers to combine (blended) indices consisting of 50% equity indices from, e.g. MSCI and 50% bond indices from, e.g., Bloomberg /Barclays or Citibank for mixed fund applications. We expect the same need with ESG data indices for the construction of a sustainability benchmark which reflects particular investor demands.

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

- ☒ Yes  
☐ No

**If you responded yes to the previous question, please specify the type of documents of materials:**

Annual reports, fund prospectus, marketing documents such as fact sheets both on-line and offline.

**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

**To what degree do 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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**Please explain your answer:**



The growing importance of ESG data, research, and rating services is reflected by the market concentration in this area which has significantly increased over the last years, due to strategic acquisitions following the drive to ESG regulation in financial services. All leading ESG data and research providers (such as MSCI, Morningstar - which acquired Sustainalytics in 2020, and Vigeo-Eiris, the biggest according to market share) are now either headquartered in the US or owned by US company groups with the exception of ISS ESG belonging to Deutsche Börse. This situation has implications for the quality and reliability of data, since investors and financial market participants need to rely on ESG research and qualitative assessments of ESG aspects as basis for ESG ratings that might not fully incorporate and take into account the development of the sustainable finance regulations, enacted e.g. in the EU. This is particularly relevant in relation to investments outside the EU, where EU investors will have difficulties to rely on corporate disclosures which do not meet the EU data and disclosure requirements. With increased ESG regulation also in the Americas and Asia this outcome cannot be deemed satisfactory from a global policy perspective.

We are concerned that many data, and especially ESG index companies, have great market power and can unilaterally set contractual conditions, since their financial services clients usually cannot easily operate their products without referring to the leading benchmarks.

## Questions for companies subject to ratings

Not applicable

## Questions for all respondents

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

- ☒ Yes
- ☐ No
- ☐ No opinion

**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)?**

Growth in demand from investors in ratings of companies for their investment decisions: 8

Growth in demand from companies in ratings including on rating future strategies:

Further standardisation of information disclosed by companies and other market participants: 9

Other:

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

- ☐ Yes, to a large degree
- ☒ Yes, to some degree
- ☐ No
- ☐ No opinion



**If you responded 'yes' to the previous question, please explain why:**

The European legal requirements for assessing and disclosing sustainability risks are becoming more demanding, and ESG ratings will be one data source among many to meet these requirements.

**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

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

Asset managers are required by regulation such as AIFMD, UCITSD, MiFID, SFDR and the EU Taxonomy Regulation to directly or indirectly use sustainability-related data. These regulatory requirements help data providers in that space to build a dominant market position and to create an oligopoly or in rare case a monopoly position on certain data and analytical approaches.

The European Commission should strongly recognise that large sustainability data providers, such as MSCI, Morningstar, ISS, hold disproportionate market power on data generated from company information. As such, sustainability data costs (the data pricing, licencing practices, definitions, audit procedures and connectivity fees) must be subject to regulatory oversight. Authorities should consider developing a cost benchmark for producing and distributing such data. In the parallel case of exchange market data such cost benchmark has been recommended in the Copenhagen Economics reports (<https://copenhageneconomics.com/publication/pricing-of-market-data/>) and in a separate paper (<https://copenhageneconomics.com/publication/a-guideline-to-a-cost-benchmark-of-market-data-how-to-obtain-reasonable-prices-of-market-data/>). The IEX exchange sustainability / ESG data cost report (January 2019 <https://iextrading.com/docs/The%20Cost%20of%20Exchange%20Services.pdf>) provides a practical use case for cost of data production disclosure in the area of exchange data.

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

- ☐ Yes
- ☒ No
- ☐ No opinion

**If you responded 'no' to the previous question, please explain why:**

The decisive factor for the use of ESG ratings is their coverage of the relevant markets. Market concentration in the ESG data business has significantly increased over the last years, in particular due to strategic acquisitions. All leading ESG data and research providers (such as MSCI, Morningstar -





which acquired Sustainalytics in 2020, and Vigeo-Eiris, the biggest according to market share) are now either headquartered in the US or owned by US company groups with the exception of ISS ESG that belongs to the Deutsche Börse group. The coverage of small and medium sized corporations is to be improved with all ESG data providers, but this is also a function of the lack of ESG information disclosed by said corporations.

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

- ☒ Yes  
☐ No

**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?**

The most established methods for assessing sustainability risks in asset management processes in our membership are implicit methods: negative screening or exclusion lists, principles-based screening, as well as investment limits and positive screening as well as best-in-class approach. Negative screening refers to the practice in which certain sectors, companies or practices are excluded from a fund or portfolio based on specific ESG criteria. Principles-based exclusions refer to the screening of investments against minimum standards of business practice based on international norms. The best-in-class approach consists in selecting the best issuers of an industry or sector in terms of sustainability performance.

More sophisticated methods that identify sustainability risks on portfolio level are less widespread than implicit methods. These embrace the exposure method, sensitivity analysis, the portfolio alignment method, stress tests and other individual methods like proprietary factor models. The portfolio alignment method describes the extent to which portfolios are aligned with global sustainability goals and what changes are required to achieve these goals. The exposure approach consists in a direct assessment of individual issuers and exposures. It is a scoring approach in which the performance of an engagement with regard to sustainability aspects is evaluated. The risk framework methods analyse by means of stress tests or scenario analysis how sustainability risks affect the risk profile of the portfolio and their standard risk indicators. Stress tests consist in building a wide range of scenarios to assess risks. Sensitivity analysis is a simplified approach for simulation of individual risk parameters under the assumption of specific ESG developments.

An interesting feature when focusing on different types of companies is that a large number of investment firms providing portfolio management services under MiFID and real estate investment companies have not yet taken action or deliver no answers regarding the implementation of more sophisticated models, which implies a major potential for the industry to further develop a toolbox of assessment methods.

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

- ☐ Yes  
☒ No



**If you replied 'no' to the previous question, would you see merit in refining the current definition of research under Directive 2014/65/EU?**

No, the definition of ESG research is different from investment research under MiFID, in particular as it does not aim at making a buy, sell or hold decision but to provide information on the sustainability characteristics of a corporation or investment and/or the relevant sustainability risk. In general, the increased availability of large volumes of financial data is influencing the assessment of investment decisions and risks (including ESG risks) of financial instruments or entities. Large data volumes show more of the diversity of qualitative and quantitative valuations. This leads to increased requirements on handling the large data volumes regarding, e.g., the actuality and the validity and also puts more demand on human capital for managing and using the data. The volumes and the time of the data availability will be used to develop early forecasts of, e.g., creditworthiness and accurate assessment of ESG risks. The asset management area is developing tools to cope with the increased digitalisation of the industry in terms of cloud computing, advanced analytics, mobile computing and robo-advice.

Asset managers in the EU are already obliged to ensure a high standard of diligence in the selection and ongoing monitoring of investments, in the best interests of the investors of the portfolios they manage and the integrity of the market. In principle, our members use data products as only one parameter when making their investment decisions. They may only make decisions if they have the appropriate professional expertise and knowledge of the assets in which they are invested. They have to ensure that the managed portfolio is only invested in assets whose risks can be adequately assessed, monitored and managed by the risk management process adopted by the company in order to warrant that investment decisions are carried out in compliance with the set investment strategy and risk limits of the investment fund. EU based investment management companies are also obliged to establish and implement written policies and procedures on due diligence. Moreover, before carrying out investments, management companies are obliged to take into account (where appropriate) the nature of the foreseen investment, formulate forecasts and perform analyses concerning its contribution to the fund's portfolio composition, liquidity and risk and reward profile. These analyses are supported by reliable, updated and meaningful information, both in quantitative and qualitative terms.

The individual assessment of the (sustainable) value or creditworthiness of financial instruments or entities is part of the overall risk management process of the investment management company and serves today as a principle against over-reliance on credit ratings. This process involves, in the light of the principle of proportionality, the assessment of any relevant risk of assets invested by the investment funds and the establishment of an internal risk limit system for any relevant risk (including ESG risk) on asset and fund level. In practice, the risk management function is obliged to establish and implement quantitative and/or qualitative risk limits for each investment fund managed by the investment management company, taking into account all relevant risks (including ESG risks).

**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?**

No, this is a fairly new market which still had niche status five to ten years ago. Also, there is no agreed framework on what constitutes sustainable investing and therefore and rightfully a plethora of research approaches exist in the area. Each individual firm or NGO is defining for themselves what ESG investing means in practical terms. Therefore, the only valid ESG investing approach to one investor may be only "greenwashing" to the next investor or NGO. This divergence of approaches is equally applicable for the variety of ESG research products available in the market. The lack of a basic



standard or common definition of sustainable investing is increasing reputational risk to the investment industry.

In practical terms, our members report the following shortcomings in the data services they contract for:

- **Lack of transparency with regard to ESG rating methodologies (forward-looking perspective)**, in particular concerning procedures for unscheduled adjustments of ratings during the year (e.g. due to controversies),
- Changes to the applied rating and ranking methodologies are sometimes not being made transparent nor consulted with clients beforehand,
- There is often a **significant time lag** concerning the ESG data that underlie ESG rating/rankings or scores which is due in part to the 12 months period for corporate sustainability reporting, but in another part to suboptimal handling processes by the data vendors, thus adding up to the problem of using potentially outdated information.

## II. Functioning of the ESG ratings market

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

- ☐ Well
- ☒ Not well

**Please explain:**

Sustainability and climate-related data and scores available in the market suffer from a lack of standardisation and comparability. This also applies for the integration of ESG factors into credit ratings by credit rating agencies (CRAs). Even though there has been some improvement regarding the overall availability of ESG data in the last years, the persisting lack of comparability and reliability has still fundamental implications for data users, i.e., investors, companies and researchers. Directly reported company data is generally not usable in practice due to the lack of comparable and standardised data, a lack of a single access point and the necessity to perform quality and data lineage checks on the reported information. This gap is currently being filled by commercial data vendors experiencing rapidly growing business opportunities parallel to the increasing regulatory requirements for the processing of ESG data for the purpose of internal processes (risk management, investment due diligence) and external client and regulatory reporting by financial market participants. Indeed, market concentration in the ESG data business has significantly increased over the last years, in particular due to strategic acquisitions. Like in the credit ratings data area the market for ESG data is largely unregulated, thus allowing the oligopoly of vendors with scope to charge excessive rents. At a minimum MIFIR (Art. 13) protections with respect to published pricelists, disclosure of price of production of ESG data reporting, and ultimately price controls based on a “reasonable commercial (i.e. cost of production) basis” (RCB should be instituted for credit and ESG ratings, rankings and data providers.

**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)?**

Lack of transparency on the operations of the providers:

8

Lack of transparency on the methodologies used by the providers

8



Lack of clear explanation of what individual ESG ratings measure	7
Lack of common definition of ESG ratings	8
Variety of terminologies used for the same products	7
Lack of comparability between the products offered	8
Lack of reliability of the ratings	7
Potential conflicts of interests	5
Lack of supervision and enforcement over the functioning of this market	8
Other	

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

3

**Please explain why:**

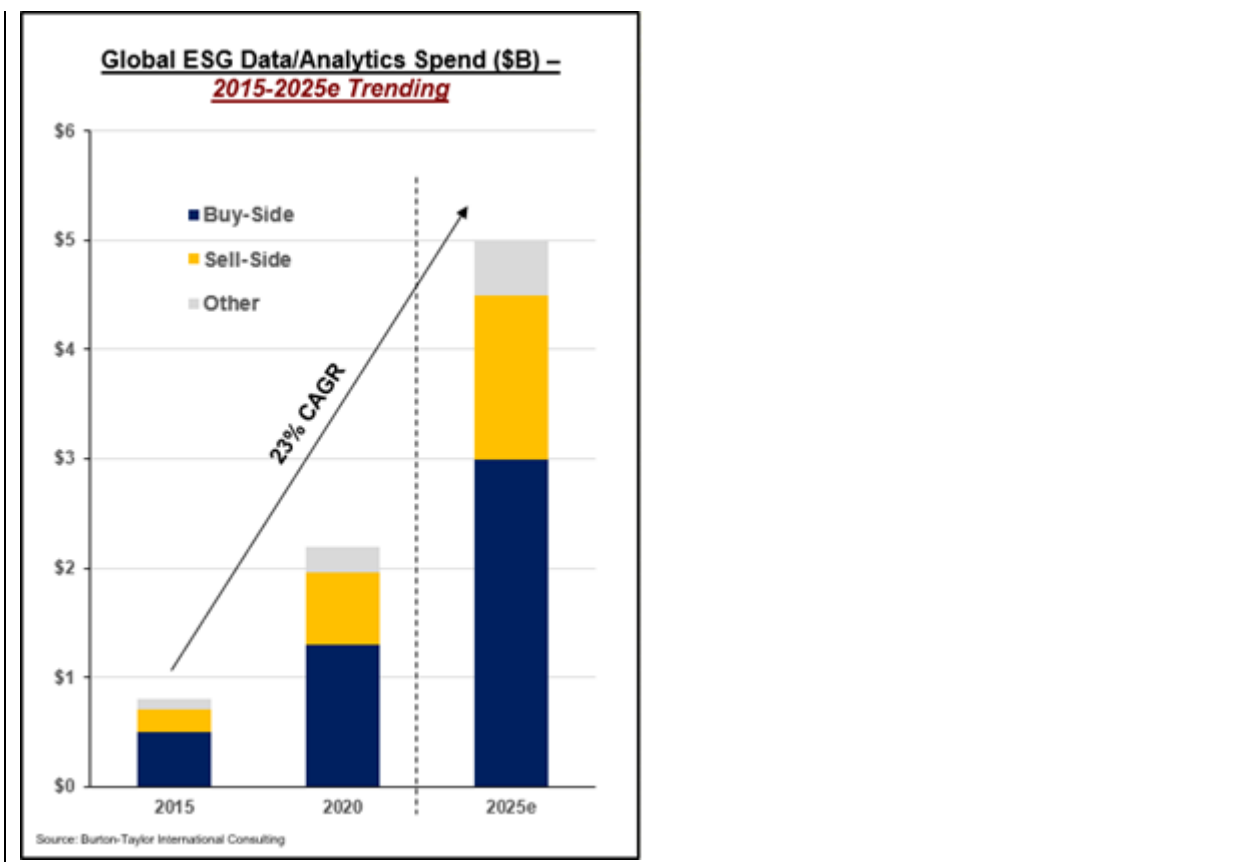
The concentration of ESG research and data providers in the US market may have implications for the quality and reliability of data, if European investors and financial market participants needed to rely on ESG research and qualitative assessments of ESG aspects as basis for ESG ratings that might not fully incorporate and take into account the development of the EU sustainable finance regulations. This is particularly relevant in relation to investments outside the EU, where EU investors will most probably not be able to refer to corporate disclosures, since such disclosures will not meet the EU requirements. This potential outcome cannot be deemed satisfactory from a general policy perspective.

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

7

**Please explain why:**

It may further strengthen the pricing and licencing power of ESG data providers. In the last years, data providers have overloaded the market with their products. The pricing frameworks remain opaque, depending largely on the combination of data modules and the size of (ESG) assets under management of the client. A mid-sized to large fund manager will spend between EUR 200,000 and 400,000 per year for a comprehensive set of ESG data. Given that the amount of required data will grow in view of the pending implementation of ESG disclosure duties, we expect this cost to rise substantially in the future driven by global regulation. Additional cost for acquisition of EU-Taxonomy-relevant data can be estimated with EUR 50,000 for the currently required set of indicators. These expenses represent a significant burden especially for small and medium-sized asset managers and asset owners such as pension funds. More competition in the ESG data market would be helpful for raising efficiency as well as product quality and lowering costs. Consultant Burton-Taylor points to an expected annual growth rate of ESG data revenues of 23% p.a. (!) and a total turnover of more than 5 Bn US\$ globally of which 3 Bn will be borne by the buy-side and ultimately the investor and pensioner on the street.



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

- ☒ Yes
- ☐ No
- ☐ No opinion

**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

**If you responded 'other biases' to the previous question, please explain which ones:**

According to academic studies, the main issues with ESG rankings and ratings seem to be systematic differences between methodologies of data providers regarding the indicators they use to measure ESG factors as well as their weights and scope (see e.g. „Aggregate Confusion: The Divergence of ESG Ratings“, MIT Sloan School of Management, August 2019). This implies that the investment decisions made upon these scores might be biased. Therefore, full transparency is needed about the rating/scoring methodologies, including a description of the underlying data and data sources used by data providers.



Methodological transparency with regard to ESG ratings/scorings is of even higher relevance than in relation to traditional credit ratings. This is because there is no universal concept of sustainability and each and every provider focuses on different aspects or attaches different weightings to the environmental, social and governance indicators. While this competition of concepts is welcomed in principle, it entails more responsibility for the users of ESG ratings to understand the rationale of each assessment in order to properly match it with the stated investment objectives of the fund and to feed it into the internal analysis and investment process.

According to the feedback from our members, the level of methodological transparency is still not satisfactory. We request comprehensive disclosure of the rating/ranking methodology applied, including procedures for unscheduled adjustments of ratings during the year (e.g. due to controversies). Changes to the methodologies should also be made transparent and consulted beforehand with clients, as in the case with credit rating methodologies under the CRAR.

As regard the general public, it is important to increase awareness about the purpose and limitations of ESG ratings or scores. While ESG ratings aim to inform about the level of sustainability risk associated with an investment, i.e. the impact of sustainability-related events on the prosperity of a company, they seem to be perceived by many as measure of sustainability. Given the growing interest in sustainable investments, it is important to avoid misperceptions in this respect, especially among retail investors.

Transparency about data sourcing and the methods used on filling of data gaps is insufficient as well. However, such transparency will be key for complying with the EU reporting requirements especially in relation to the EU Taxonomy and the principal adverse impacts (PAIs). Given that under the SFDR RTS financial products shall be only allowed to rely on third-party data for calculating their proportion of Taxonomy-aligned investments if such data is either reported by companies under Article 8 Taxonomy Regulation or qualifies as “equivalent information”, it will be of key relevance for the user community to distinguish data obtained or derived from companies’ disclosures from other data points based especially on estimations or extrapolations, such as ESG benchmarks established on certain industry sectors within the economy. ESG data providers should take immediate steps to ensure this basic level of transparency about data sources.

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

- ☐ Yes  
☒ No  
☐ No opinion

**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)?**

7

**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):**

There is a lack of transparency on the methodology and objectives of the respective ratings

8



The providers do not communicate and disclose the relevant underlying information	8
The providers use very different methodologies	8
ESG ratings have different objectives (they assess different sustainability aspects)	8
Other issue(s)	

**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:**

ESG covers a broad field. There is no agreed framework at national, EU or global level on what constitutes sustainable investing. Each individual firm or NGO is defining for themselves what ESG investing means in practical terms. Therefore, the only valid ESG investing approach to one investor may be only a 'greenwashing' approach to the next investor or NGO. Rightfully a plethora of research approaches exist in the area. It is therefore entirely appropriate for individual data providers to focus only on all or only specific environmental concerns and others on social or governance aspects. This also serves competition. Asset managers are the trustees of their investors. It is not up to the asset manager to decide which sustainable investing approach is best for the investor.

**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)?**

7

**If you consider that this market is very much prone to conflicts of interests, where do you see the main risks?**

- ☒ 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

**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)?**

1

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





More competition in the ESG data market would be helpful for raising efficiency as well as product quality and lowering costs. However, all leading ESG data and research providers are currently favoured for their broad coverage – also in combination with providing additional data services. However, buy side firms such as asset managers are looking to identify and portray their own ESG-based comparative advantages and specialisms, and are becoming more demanding and analytical in their risk assessments and investment decisions. This could provide a growing opportunity for smaller ESG data providers with niche data or differentiated processes to penetrate the market. Also, the ESAP will be a differentiating factor in this respect in the EU as it could allow smaller players to collect easily and free of charge the necessary raw company data enabling them to offer value added ESG analytics and products.

**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)?**

3

**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

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

- ☐ Yes
- ☒ No
- ☐ No opinion

**If you responded 'no' to the previous question, please specify what you consider should be the minimum information to be disclosed:**

Given the importance of the provision of benchmark data to the well-functioning of financial markets we recommend ensuring that benchmark data and ESG ratings are made available to users at a fair price. The recommendations which could be implemented by the ESG data and index providers themselves are the following:

- **Impose a cost-based licencing mechanism:** Any benchmark data licence costs should in principle be based only on the incremental/marginal cost of providing and distributing a given data service plus a reasonable profits margin defined once and which can increase only with inflation.
- **Impose transparency on costs and prices:** In order to reduce disputes related to licence fees, users should have access to meaningful written information, including price lists on all data products and services and cost of data production reports, which enable the reader to recalculate the actual costs based on the applicable pricing methods. This should include cost calculation methods as well as the guidelines on the allocation of fixed and variable costs, including the cost of third parties and the costs of the provision and distribution of benchmark data offerings.





- **Impose best practices on high impact data licences:** Certain high-impact benchmark data licence practices which have significant negative consequences for end clients and financial markets should be subject to stricter controls. For example, the practice of data cut off by the data provider or vendor should only be allowed following a court or court of arbitration judgement.
- **Clear responsibility for index calculation errors:** There is a pressing need to hold index administrators responsible for any calculation errors and recognize how integral financial indices impact the implementation of investment management strategies – especially for index-tracking ones (like ETFs) – and how critical index quality is to their success for investors.
- **Keep data unbundling:** The user side of benchmark market data should only pay for data they are interested in rather than being forced to buy additional services. Benchmark data providers should always inform customers that the purchase of the benchmark is available separately from the purchase of additional data (for example licence for constituents). Furthermore, benchmark data providers should not condition the purchase of individual benchmarks to the purchase of a broader range of benchmarks (in which there may be little interest).
- **Improve transparency:** Data users have concerns about the inventiveness of benchmark providers in creating new use cases or categories of licence. Due to a lack of standardisation for licence concepts, fund management companies and banks do not have the ability to compare the licence models across different index providers. More transparency, such as public pricelists on all data products and services, harmonised templates and standardisation of definitions of key terms and concepts used in licence data agreements, would be helpful in better understanding the criteria for such use cases and the avoidance of paying several times over for the same data.

### III. EU intervention

#### a) Need for an EU intervention

**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:**

We strongly encourage all ESG data and benchmark providers to adhere on a voluntary basis to the key recommendations on cost and licence transparency as soon as possible. Such action could be initiated by way of an open dialogue with the major data providers and must not necessarily entail regulatory intervention.

However, the European Commission should strongly recognise that large sustainability data providers, such as MSCI, Morningstar or ISS, hold disproportionate market power on data generated from company information. As such, sustainability data costs (the data pricing, licencing practices, definitions, audit procedures and connectivity fees) must be subject to regulatory oversight. Rigorous



supervision of the entire sustainability / ESG data business (as well as contiguous markets and products where the search for revenue could shift once there is increased scrutiny of sustainability / ESG data sales) is crucial in order to maximise the economic and social benefits of the use of ESG data.

Furthermore, it should be required by law that ESMA should collect annual information on pricing, licences, costs, and revenues per types of ESG ratings and ancillary services in addition to fees and costs for rating related products and services sold by both regulated (e.g., BMR, CRA firms) and other entities within the group. Collecting information on these items would lead to a better understanding of the services provided by rating agencies and their entities within the group. Particular attention should be paid to any “bundled services”, i.e. binding purchase of ESG scores when sourcing ESG data.

In addition, we believe that a uniform quality standard for the assessment process of external ESG ratings is necessary. In this context, market data providers issuing ESG ratings could also be regulated.

The lack of transparency with regard to ESG rating methodologies (forward-looking perspective), in particular concerning procedures for unscheduled adjustments of ratings during the year (e.g. due to controversies), could also be an issue for an intervention at EU level.

From the perspective of the users of ratings, however, we would like to point out that it is already foreseeable from the past regulation of credit rating agencies that the costs of implementation new ESG rating regulation will be transferred by ESG rating providers to the users of ratings. However, due to the gaps and inconsistent practices to date, uniform regulation is likely to be preferable, also in consideration of the expected implementation costs. With expanding regulation, the rating data providers may establish more and more licences. Because of the rising costs of data-feeds, there must be a solution to stop this behaviour through a combination of basic ratings data which is available on ESMA's /ESAP's data website (and perhaps rating data providers' websites) which are fee and licence free for use in the whole value chain of asset management. We need a minimum regulation of other proprietary data feeds in terms of making available pricelists, cost of data production reports, and a cost-based pricing similar to what is currently already required from exchanges under MiFID rules. Rating agencies proprietary value-added data and research services will be the main revenue stream for the agencies other than rating fees going forward and will have to coexist with the European data platform.

**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

**If you responded yes to the previous question, what do you consider should be the prime focus of the intervention?**

- ☒ 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).

**For each of the points you selected in the previous question, please explain what solutions and options you would consider appropriate in order to improve transparency on the operations of the providers:**

We refer to our statement above.

**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:**

ESG rating providers should be subject to an authorisation or registration system as they handle massive amounts of data from assessed companies, at times confidential ones.

However, we see the link to the new European regulation on the digital operational resilience act (DORA) which also deals with critical ICT providers (including market data providers) and a minimum supervision. It should be therefore analysed whether and to what extent additional supervision based on sector specific regulation (MiFIR, BMR, CRA, ESG data regulation) would be needed. A better alternative could be a horizontal act building upon the DORA framework which covers the commercial activities of all data providers and data (re)vendors active within the EU as suggested, e.g., by Paris/Europlace.

**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:**

Please see above.

**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:**

Please see above.

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

- ☒ Yes
- ☐ No
- ☐ No opinion

**Please explain your answer:**

Standardised templates for disclosing information on the methodology would strengthen transparency as well as comparability and ease due diligence (in particular in combination with the implementation of ESG rating standards).

**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

**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

**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



## **b) Costs of an EU intervention**

### **Questions for ESG rating providers**

Not applicable.

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

### **I. Questions to users of credit ratings**

#### **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

#### **Do you use credit ratings for regulatory purposes (e.g. stemming from the Capital Requirements Regulation or Solvency II)?**

- ☒ Yes
- ☐ No
- ☐ These requirements don't apply to me

#### **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

#### **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:**



Our members report that CRA company and issuance research are usually not included in contracts for ratings data but require a separate subscription. Methodology documents and consultations also on how the rating process incorporates sustainability factors should be available for free at the respective CRA websites.

In order for issue-based credit ratings data to be usable in fund management daily practice it is important that the data obtained can be used freely in all internal and external (especially in client and regulatory reporting) situations. CRA website use is occasional only, as data are usually allowed for „view only“, and can be downloaded only on an individual rating basis. Most members therefore use payable CRA data-feeds in the absence of large number download possibilities on CRA websites. The CRA websites in their current form are not fit for institutional investor and asset manager use of rated issuance data. CRA websites may be useful to assess the credit risk of small bond portfolios usually held by retail investors or for one-off academic studies on a static pool of bonds. Similar considerations apply to the ESMA operated ERP. ESMA made suggestions how to improve the ESP accessibility and usability in a report in October 2021 which we support. In the alternative CRA ratings data could be included in the ESAP alongside non-financial (ESG) information from 2025 onwards.

Beyond rated issuance data, our members use the websites (primary) to download on a selective basis information related to methodology, default studies or to address ad hoc information needs on specific issuers or asset classes to support internal processes of asset managers. Usually access to information is at least restricted to registered user and often requires a payable data licence.

#### **Where do you look currently for the information on how ESG factors impact the credit rating?**

- ☒ 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

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

- ☒ Yes
- ☐ No
- ☐ No opinion

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

In general, both website and data feed licence terms and conditions (ToC) are difficult to find and understand. Also the application of the CRA's data ToC to data obtained from the ESMA website is not clear.



**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?**

- ☐ 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.**

**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

## **II. Questions to Credit Rating Agencies**

Not applicable.

## **III. Questions on the need for EU intervention (all respondents)**

**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

**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

**If you responded ‘no’ to the previous questions, what type of intervention would you consider necessary?**

- ☒ 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

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

It should be required by law that ESMA should collect annual information on pricing, licences, costs, and revenues per types of ratings and ancillary services in addition to fees and costs for rating-related products and services sold by other entities within the group. Collecting information on these items would lead to a better understanding of the services provided by rating agencies and their entities within the group. Particular attention should be paid to any “bundled services”, i.e. binding purchase of ESG scores when sourcing ESG data.

**Regarding the possible regulatory intervention, what type of requirements do you find relevant?**

- ☒ 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

**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

**What would be the consequences of the lack of the EU intervention?**

- ☐ 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

### **Costs of EU intervention - questions for CRAs**

Not applicable.

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