

EuropeanIssuers' Position on the Proposed EU Regulation on the transparency and integrity of ESG rating activities

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EuropeanIssuers has followed the debate on ESG ratings and the possible regulation of the market very closely because ESG ratings have become increasingly relevant for access to finance and financing costs of companies (EU members and beyond) as well as for the investment process.

At the same time, and despite of the high importance of ESG ratings, issuers observe that the market for ESG ratings still has some significant deficits regarding standards of business conduct, dialogue with rated entities, data quality and overall transparency of the rating methodologies and rating process.

Against this background, EuropeanIssuers strongly supports the EU Commission's proposal as it aims to ensure that only rating providers complying with minimum standards regarding business conduct, conflict of interest management, and transparency are allowed to operate on the EU market. The provisions of the proposal will thus help to improve reliability, comparability, and transparency of ESG ratings for the benefit of both investors and rated entities.

However, with regard to certain aspects a more ambitious approach should be taken in order to fully take into account the realities of the ESG ratings and data market and for the benefit of delivering and ensuring efficiency, fairness and confidence in the ESG rating market.

In particular we would like to comment on the following three key elements of the proposal:

Scope: "controversy reports" and "processed ESG data" must be covered appropriately

In order to be effective, the scope of the regulation needs to be carefully defined. From the issuers' perspective there are at least two points with respect to the scope that should be discussed and appropriately addressed.

First, it has to be ensured that controversy reports aiming at flagging current or past ESG controversies for investors are addressed by the regulation. Such controversy reports often have a bigger impact on investment decisions than changes in an overall ESG score. It is the issuers' experience that even a single controversy listed in such a report can lead to a red flagging of the respective issuers, an exclusion from the investment portfolio, or a blocking of new investment in the respective security. Issuers also experience that long lists of news items

of unconfirmed incidents from years back are “added up” to a lump sum reduction from an overall score. It is therefore essential that detailed transparency requirements on the precise methodology applied to controversy reports are introduced, that the highest professional standards apply for the providers of controversy reports and that issuers’ complaints in this respect are handled with high priority.

Secondly, the provision of processed ESG data should be appropriately addressed by the regulation. Also here, issuers notice that this data often plays a more important role in the investment process than overall scores, because larger investors in particular use their own ESG methodologies for their investment decisions which are based on ESG data sold from ESG data providers who are not always sufficiently transparent on the processes they use to aggregate, estimate or transform the data. Thus, the provision of processed ESG data by data providers should be subject to appropriate transparency requirements around processes and controls to improve data integrity and reliability. The proposal of the Commission can serve as a basis for further consideration.

Dialogue with and complaints from issuers: reliable interaction and fair treatment of issuers’ concerns needs to be ensured

Another crucial aspect of the proposal is the complaints procedure under Art. 18 which we fully support. For a fair treatment of issuers their complaints must be treated in a professional, independent and timely manner. This must include enforceable obligations for rating providers to correct data errors and/or outdated controversies. There should be a clear time limit for rating providers to respond to complaints, and there should be a right of appeal.

In addition, the regulation should be drafted in a way that reduces the likelihood of complaints about data errors, wrong application of methodologies or unfair overall treatment. This can be ensured by introducing an obligation for ESG rating providers, for example in Article 14, to engage with the rated entity before publication of the rating, e.g., by giving the rating entities the right to respond to the draft rating within a reasonable time before it is published.

Transparency: particular care should be taken with the Annexes

EuropeanIssuers very much welcomes that the proposal significantly improves the transparency of ESG rating providers in Art. 21 and Art. 22 because the lack of transparency aggravates the problems due to the existing variety in terms of professionalism, methodologies and rating results.

Though the approach of the Commission is overall reasonable, we encourage co-legislators to keep or add requirements that would help issuers to fully understand the methodology of an

ESG rating (e.g. granular information of metrics and expectation), to ease the dialogue between companies and providers (e.g. information on contact person, timing of ratings processes) and to inform the market of the quality of incorporated data (e.g. public data vs. company data, information about the last update of data points). These points may be dealt with in detail on level 2. However, annexes need to be drafted in a way that provide for appropriate level 2 acts.

EuropeanIssuers is convinced that the regulation of ESG ratings is an important step to recognise the significant importance which ESG information and ESG ratings have gained during the past years. We are convinced that the EU Commission's proposal together with the amendments we propose is a good basis to deliver an appropriate framework to improve reliability, comparability and transparency of ESG ratings and the underlying processes and data sources.

EuropeanIssuers would appreciate to discuss the issuers' perspective with the co-legislators and stays at your disposal for further queries and discussions.