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 ratings[2]

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.

B. Specific requirements in terms of governance and management of conflicts of interest should be adopted[3]

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 provision[4]

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.

D. Supervision should be organised at the European level to ensure harmonized application and supervision[5]

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.

Annex 1: AFM's responses to the questions in the consultation

EUROPEAN COMMISSION
DIRECTORATE-GENERAL FOR FINANCIAL STABILITY, FINANCIAL SERVICES AND CAPITAL MARKETS UNION

Financial markets
Corporate reporting, audit and credit rating agencies

CONSULTATION DOCUMENT

TARGETED CONSULTATION ON THE FUNCTIONING OF THE ESG RATINGS MARKET IN THE EUROPEAN UNION AND ON THE CONSIDERATION OF ESG FACTORS IN CREDIT RATINGS

Disclaimer

This document is a working document of the Commission services for consultation and does not prejudge the final decision that the Commission may take.

The views reflected on this consultation paper provide an indication on the approach the Commission services may take but do not constitute a final policy position or a formal proposal by the European Commission.

The responses to this consultation paper will provide important guidance to the Commission when preparing, if considered appropriate, a formal Commission proposal.

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https://ec.europa.eu/info/business-economy-euro_en

You are invited to reply **by 6 June 2022** at the latest to the **online questionnaire** available on the following webpage: https://ec.europa.eu/info/publications/finance-consultations-2022-esg-ratings_en

Please note that in order to ensure a fair and transparent consultation process **only responses received through the online questionnaire will be taken into account and included in the report summarising the responses**.

This consultation follows the normal rules of the European Commission for public consultations. Responses will be published in accordance with the privacy options respondents will have opted for in the online questionnaire.

Responses authorised for publication will be published on the following webpage: https://ec.europa.eu/info/publications/finance-consultations-2022-esg-ratings_en

Any question on this consultation or issue encountered with the online questionnaire can be raised via email at fisma-esg-ratings@ec.europa.eu.

INTRODUCTION

The first part of the consultation aims to inform the Commission on the dynamics relating to the ESG ratings market, and on the interplay between larger and smaller market players. This section aims to inform on the use and objectives of ESG ratings.

The second part of the consultation aims to identify possible shortcomings in relation to the consideration of sustainability risks in credit ratings and the disclosures made by CRAs.

CONSULTATION QUESTIONS

PART A – ESG RATINGS

Background information

ESG ratings are used by a wide variety of investors as part of their sustainable investment strategy to take into account risks and opportunities linked to ESG issues. Consequently, these ratings have an increasingly important impact on the operation of capital markets and on confidence of investors in sustainable financial products. For the purposes of this consultation the term ESG ratings is based on the definition provided in the International Organization of Securities Commissions' (IOSCO) final report on environmental, social and governance (ESG) ratings and data products providers (21 November 2021).

ESG ratings: refer to the broad spectrum of ratings products that are marketed as providing an opinion regarding an entity, a financial instrument or a product, a company's ESG profile or characteristics or exposure to ESG, climatic or environmental risks or impact on society and the environment that are issued using a defined ranking system of rating categories, whether or not these are explicitly labelled as "ESG ratings".

Due to the importance and growth of this market, and potential issues identified as to its functioning, in the action plan on sustainable finance, published in March 2018, the Commission announced a study to be conducted to dig further into the specifics of this market.

The study on sustainability-related ratings, data and research ('the study') was published in January 2021. The study identified a number of issues pertaining to the functioning of the market of ESG ratings providers, in particular on transparency around data sourcing and methodologies, as only few firms disclose the underlying indicators or their actual weights of their assessment. The study also highlighted issues in terms of timeliness, accuracy and reliability of ESG ratings. Another issue identified related to biases, based on the size and location of the companies. Finally, it highlighted potential conflicts of interest associated with certain aspects of their work, including where providers both assess companies and offer paid advisory services or charge companies to see their own reports.

As part of the consultation on the renewed sustainable finance strategy, which took place in early 2021, the Commission asked stakeholders about their views on the quality and relevance of ESG ratings for their investment decisions, on the level of concentration in the market for ESG ratings and need for action at EU level. This confirmed the conclusions of the study, Stakeholders indicated that better comparability and increased reliability of ESG ratings would enhance the efficiency of this fast growing market, thereby facilitating progress towards the objectives of the EU green deal.

This consultation will directly feed into an impact assessment that the Commission will prepare in the year 2022 in order to assess in detail the impacts, costs and options of a possible EU intervention. This consultation should help further clarifying and quantifying the main findings from the study and input received from market participants.

On 3 February 2022, the European Securities and Markets Authority (ESMA) published a call for evidence, complementary to this consultation, in order to support the exercise and provide a mapping of ESG rating providers operating in the EU. The call for evidence also looks at possible costs of supervision would these providers become subject to some supervision.

Subject to the result of this impact assessment, the Commission would propose an initiative to foster the reliability, trust and comparability of ESG ratings by early 2023.

This consultation also seeks views from market participants on the use of other types of tools that can be offered by sustainability-related providers, including research, controversy alerts, rankings, etc.

I. Use of ESG ratings and dynamics of the market

The study identified a rapid growth in global assets committed to sustainable and responsible investment strategies over the last decade, which is forecast to continue as sustainable investing becomes fully integrated into asset management.

This leads to higher demand by investors for ESG ratings to help them decide on particular investment strategies.

The study identified two key trends over the past five years - being consolidation and reinforcement of the established ESG ratings providers, and growth in the overall number of providers due to new market entrants.

The study also highlighted that it is challenging for new market entrants to replicate and compete with the larger providers due to high initial level of investment needed to cover a broad range of ESG issues, with as many as a thousand data points, across thousands of companies.

1. Questions for investors, asset managers and benchmark administrators

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

2. **Please explain**

3. **Which type of ESG ratings do you use (non-exhaustive list – multiple answers possible):**

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

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

6. **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?**

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

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

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

10. **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?**

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

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

13. **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?**

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

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

16. **What do you value and need most in ESG ratings:**

17. **If you responded 'other aspects' to the previous question, please explain why :**

18. 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)?

2. Questions for companies subject to ratings

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

20. 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)?

21. 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?

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

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

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

3. Questions for all respondents

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

- Yes
- No
- No opinion

26. 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: 10
- Growth in demand from companies in ratings including on rating future strategies: 5
- Further standardisation of information disclosed by companies and other market participants: 7
- Other

27. If you responded 'other' to the previous question, please specify the other reasons you see for this market to continue to grow

The ESG rating and other ESG data and services market is expected to continue to grow quickly due to increase in investor demand, the growing and broadening of stakeholders that will require these products and the continuous innovation of its players. It is estimated by a 2020 UBS study that global revenues generated by ESG data and services could double by 2025, up to \$5,1 bn. Next to investor demand increasing (10) recent developments indicate that there will be a growing demand from companies subject to ESG ratings (5). This demand is fueled by as companies will want to incorporate ESG ratings into their public communication or for linking their directors' remuneration to sustainable objectives. Likewise, ESG ratings will be required by both issuers and users for specific products, such a sustainability-linked bonds in which the coupon rate is partly determined by ESG scores/ratings of the issuer. Moreover, the European regulatory sustainability framework and the correlative development of new ESG products by providers will also fuel these demands (10). This developing regulatory framework will require undertakings to use significantly more ESG products and services. Finally, as investors will develop multiple information-specific needs, providers will develop new products (such as taxonomy-related tools or specialized scoring which will increase demand (8).

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

29. If you responded 'yes' to the previous question, please explain why

30. If you responded 'no' to the previous question, please explain why

31. 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

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

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

- Yes
- No
- No opinion

34. If you responded 'yes' to the previous question, please explain why

35. If you responded 'no' to the previous question, please explain why

Most of the providers of ESG ratings have their headquarters outside the EU. In a 2020 mapping of stakeholders by the AMF, they found that 80% of the 25 players of its sample had their registered office outside the European Union, mostly in the United States and to a lesser extent in Switzerland and the United Kingdom.

It is not a necessarily a problem that these ESG rating providers have their HQ outside of the European Union. However, if this results in providers not being accountable for the quality of their services due to them being unregulated, this constitutes a risk and could harm the working of potential EU legislation and the objectives of the European sustainable finance strategy. If undertakings rely non-EU ESG rating agencies that do not apply the European sustainability framework, then this could have impact on investment allocations and engagement policies of investors. It might be necessary to demand presence in the EU or create a third-country regime in the case of similar regulatory safeguards in the country where the rating agency has its seat.

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

- Yes
- No

37. 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?

Even though we, as a national competent authority, do not buy these services ourselves, many asset managers indicate to us that they use a variety of products related to ESG ratings and data to guide their investment decision.

There will be an increase in the demand of ESG assessment tools other than ESG ratings, such as data provision of not-publicly available data. One of the reasons for this is the current and upcoming legislation arising from the EU sustainable action plan for financing sustainable growth. These require more ESG assessment tools in order to adhere to their legal obligations and to fulfil the wishes of investors to screen, rank,assess or report ESG information.

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

- Yes
- No

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

For the purpose of this question, the AFM considers that ESG research products cover the wide range of ESG data, rating and services products, which includes in particular ESG data, scoring, controversies research, screening or taxonomy-related tools. Sufficient diligence should be ensured by all users of ESG data, ratings and services products. Several EU regulations provide for investors to ensure a high standard of diligence in the selection and monitoring of their investments. In particular, Directive 2010/43 Art. 23 of and Delegated Regulation 231/2013 art. 18 both introduce mandatory due diligences for asset managers and AIFM in the selection and monitoring of investments. However, asset managers and AIFM are not the only users of ESG data, ratings and services and the risks associated with these products should be more generally addressed. In addition, ensuring such due diligences is made on users' side will also not address the different issues and risks identified in relation to the market of ESG data, ratings and services. Limited transparency on methodologies and underlying data as well as on the management of conflicts of interests limits the capacity of users to proceed with their due diligences. Market participants indicate that the market dominance of a few very large providers of ESG ratings and data, on which they rely in order to fulfil many regulatory requirements with regard to transparency and risk management, makes it difficult to press on when a provider does not satisfy their questions. The AMF and AFM position paper hence calls for a mandatory regulatory framework at European level that should take into account the specific features of the ESG data, analysis and services market and should enable innovation. Greater transparency on methodologies, and management of conflicts of interest should be the cornerstone of this regulation. Specific requirements on internal controls and governance should be laid down to ensure reliability and quality of the services provided and proper management of potential conflicts interests. These governance requirements should, among other things, ensure that a consistent, timely, and knowledgeable application of ESG rating methodologies is applied by providers.

Finally, refining of the current definition of research under Directive 2014/65/UE presents limitation and should not be envisaged as a viable solution to address the current "black-box" situation described by users and the risks it presents to investor protection and the objectives of the EU's sustainable finance strategy. Attention should in particular be given to the fact that MiFID II only applies to investment firms when the majority of players in the analysed market are not registered under this status; it also does not deal with the methodology of research production.

40. 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?

The definition and measurement of nonfinancial performance are not yet mature and providers tend to adopt different definitions of ESG performance that evolve in time. Indeed, research shows that the correlation between ESG ratings of different providers is quite low, especially when compared to the near 100% correlation of credit ratings. Providers adopt different methodological choices as regards to the concepts they include, how to measure them and how to weigh all the underlying indicators in a final score. In some occasions Environmental, Social and Governance evaluations are added together in a single final score or rating whereas in others they are scored separately. In some cases, the rating, score or other type of assessment is based on a risk perspective for the company, while in other cases, it is based on impact of the company on environment and society. This is in part due to the different client needs. Moreover, the constant reassessment of ESG rating provider of what ESG performance entails leads to continuing changes of ESG ratings.

Due to the differences between ESG rating providers, transparency regarding the methodology and process is essential for users to compare ESG ratings and other ESG information.

"The stake for investors 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, including when comparing ratings from different providers. This information is also necessary for regulators to be able to monitor the markets. This information is also necessary for regulations to be able to monitor the markets."

Because of the risks and potential harm that can come from incomparable or non-understandable ESG ratings, it is paramount to define transparency standards on methodologies. This will help increase the comparability of the different methodologies used by ESG service providers while still allowing these providers to design methodologies with sufficient levels of flexibility. It is important that providers have this level of flexibility as ESG research products are not mature enough to standardize methodologies.

Comparability will also be ensured through greater transparency on underlying data. Alongside the limited transparency on methodologies, users report harmful opacity on the nature and source (reported by the entity, provided by a third party, estimated) and up-to-date nature of the underlying data. It is indeed common for ESG product providers to deal with data gaps and estimated data can play an important in the final ratings when methodologies rely on an extended number of data-points (some actors include up to a thousand) or on specific actors of regions with less data available. It is therefore important that providers of ESG data, ratings and services clarify the sources of the information they collect (e.g. use of public information and/or questionnaires sent to companies and/or meetings with rated entities and/or the future European database) as well as the proportion of estimates used and how those estimates have been calculated. Clarity on the underlying data and on the methodologies will also allow rated entities to better understand the analyses made and ensure that the data used is accurate and up to date.

II. Functioning of the ESG ratings market

The study identified several issues on the functioning of the ESG ratings market that may hamper its further development.

In particular, there is an overall demand for greater transparency of objectives sought, methodologies adopted and quality assurance processes in place ESG rating providers.

The timeliness, accuracy and reliability of the output from ESG ratings providers were also identified as issues for the good functioning of this market.

Another issue identified in the study concerns the existence of biases and low correlation across ESG ratings.

The potential for conflicts of interest, particularly associated with providers both evaluating companies and offering paid advisory services, was further highlighted. The study stressed that providers selling multiple products require an appropriate separation between departments to avoid potential conflicts of interest.

This section aims to inform on the functioning of the ESG ratings market and potential issues that hamper its development and trust by market participants.

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

- Well
- Not well

42. Please explain

The 2020 AMF-AFM position paper "Call for a European Regulation for the provision of ESG data, ratings, and related services" describes several key issues in the market for ESG ratings and data that are still relevant today. Amongst the weaknesses identified, the lack of transparency on methodologies and objectives of the products as well as on the underlying data stand out as major difficulties that could entail risks of misallocation and missed opportunity, jeopardising the Commission's objectives on sustainable finance, and risks of greenwashing

The very strong development of the demand for ESG products and the high innovation capacity of the players also present risks of conflicts of interest. ESG rating providers can assume different roles such as consultant, data provider or rating agency, and represent diverse interests from issuers to investors. It is therefore important that potential conflicts of interest are managed and averted, ensuring an appropriate level of market transparency.

Such risks will be all the more acute as the product offer will continue to develop and be incorporated in different investment products, paving the way to possible contagious effects and overreliance risks. ESG ratings lie at the basis of the production of ESG indices and benchmarks in particular and therefore determine investment decisions in the market for passive investments.

43. 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: 10
- Lack of transparency on the methodologies used by the providers: 10
- Lack of clear explanation of what individual ESG ratings measure: 10
- Lack of common definition of ESG ratings: 8
- Variety of terminologies used for the same products: 5
- Lack of comparability between the products offered: 7
- Lack of reliability of the ratings: 10
- Potential conflicts of interests: 10
- Lack of supervision and enforcement over the functioning of this market: 9
- Other

44. If you responded 'other' to the previous question, please explain which ones:

Lack of transparency on underlying data constitutes an important shortcoming of the ESG rating market. The main reason that ESG ratings diverge is due to differences in the underlying data. The scope of information/indicators that on which the rating is based and how the rating is measured are the most important factors that attribute to differences in ESG rating by providers.

ESG data, still under construction and often unavailable, is a key element of ESG ratings. As some providers cover a broad range of ESG issues, they revert to variety of information vectors and channels in order to find this information. Sources could be the following: questionnaires sent to companies, use of information published by the entities concerned by the data or by trusted third parties (press agencies, non-governmental agencies), use of data produced by other suppliers of the sector through subscriptions or partnerships. Moreover, this information is often supplemented or corrected by the companies themselves. This poses a risk as these companies could be biased to correct the data in their favor.

Additionally, the existence of data gaps and the untransparent practice of data estimation to fill in these gaps. It is estimated that more than 60% of the underlying data is based on estimates.

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

46. Please explain why:

47. If you responded 'very poor' or 'poor' to the previous question, wo 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)?

48. Please explain why

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

- Yes
- No
- No opinion

50. 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

51. If you responded 'other biases' to the previous question, please explain which ones

Other biases could be industry biases, where ESG rating providers oversimplify industry weighting and company alignment that assume that companies in the same industry face exactly the same risk. As a result there could be biases in the methodology that result in certain undertakings attaining better ratings and some undertaking attaining worse rating than they should have in reality. Another bias exists in the form of ESG information availability per sector/industry. Certain sectors will have more data available and other will have more data gaps. Depending on how rating providers choose to deal with data gaps, this could have an impact on an undertaking's overall rating. If, for example, rating agencies choose to give a low score for missing data then this could result in biases for undertakings in industries with low ESG information availability.

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

- Yes
- No

- No opinion

53. 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)?

Low levels of correlation between various types of ESG ratings are not a problem in itself. However, in order to ensure comparability there needs to be transparency about why these low levels of correlation exist. If there is transparency about the methods and underlying data then this ensures that companies themselves, users, and regulators will be able to have an understanding of these ratings. This understanding will allow the ratings to be comparable and is key to avoid risks of misallocation and missed opportunity.

54. 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: 10
- The providers do not communicate and disclose the relevant underlying information: 10
- The providers use very different methodologies: 3
- ESG ratings have different objectives (they assess different sustainability aspects): 3
- Other issue(s)

55. If you responded 'other issue' in the previous question, please explain which one(s)

56. 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

57. Please explain your response to the previous question :

The variety of types of ESG ratings and various approaches and methodologies being used is coherent with the existence of a plurality of perspectives from ESG rating agencies and demands from investors. The variety of ESG ratings can follow from the inherent multidimensional nature of ESG performance, while this is perhaps less the case when the rating covers ESG risk rather than impact. Some providers may specialize in a certain topic/field and some users may want to prioritize certain topics/field. Thus, this plurality allows for specialization, development and innovation. Therefore, a mandatory European regulatory framework should not hamper this innovation by prescribing set methodologies. Instead, the AFM is of the opinion that the focus should be on ensuring greater transparency. It should be crystal clear what the ESG rating measures and what the objective of the rating is. This increased level of transparency

will allow for comparability and understandability of ESG ratings while retaining the specialization, development and innovation of the industry.

58. 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)?

10.

The very strong development of the demand for ESG products and the high innovation capacity of the players present risks of conflicts of interest. ESG rating providers can assume different roles such as consultant, data provider or rating agency, and represent diverse interests from issuers to investors. Rating and data agencies can provide consulting services such as portfolio analysis, the provision of certification and second-party opinions, advisory services on corporate ESG strategy, and regulatory reporting assistance to comply with new sustainability regulations or how to improve an ESG rating. It is therefore important that potential conflicts of interest are managed and averted, ensuring an appropriate level of market transparency.

Together with greater transparency on methodologies, management of conflicts of interest should be one of the cornerstone of any regulation of ESG ratings, data and other ESG products.

59. 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

60. If you responded 'other(s) conflicts of interest' to the previous question, please specify the additional risks you see

61. 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)?

62. What barriers do you see for smaller providers?

The main barrier to entry for smaller providers is the lack of access to data. ESG rating services are resource intensive due to the large amounts of data that needs to be processed and the lack of publicly available data. For smaller providers to be competitive with their larger counterparts they will need the resources and skills to be able to gather, analyze and synthesize large amounts of diverse information. Additionally, in order to safeguard the development and innovation of start-ups and smaller local providers, the AFM emphasizes the need for proportionality in any kind of regulation on the basis of size and revenue in order to avoid unnecessary regulatory hurdles.

63. 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)?

64. 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)?

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

- Yes
- No
- No opinion

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

III. EU intervention

In light of the current situation and recent developments of the ESG ratings markets, and the potential issues affecting it, this section aims to gather stakeholder views on the need and type of a possible intervention at EU level.

a) Need for an EU intervention

67. 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

68. Please explain why :

In December 2020, based on their regulatory experience and detailed analysis of the ESG data, ratings and services market, the Autorité des marches financiers (AMF) and the Autoriteit Financiële Markten (AFM) jointly called for the creation of a European regulatory framework for providers of sustainability-related services aimed at preventing misallocation of investments, greenwashing and ensuring investor protection. The position paper deemed such new regulation should become part of the Commission's renewed sustainable finance strategy to strengthen the overall framework for sustainable finance.

Indeed, ESG data will continue to play a key role in reaching the ambitious objectives of the EU's sustainable finance strategy and the Green Deal, supporting the shift towards greener economies. While structural steps are currently underway at EU level to ensure the relevance, reliability and comparability of ESG data reported by companies, notably through the targeted legislative action of the CSRD and the definition of common standard by EFRAG, these will not bring all-encompassing solutions. The role and influence of ESG data, rating and services providers will continue to grow together with the range of products and services they offer to market participants.

Greater transparency on methodologies, and management of conflicts of interest should be the cornerstone of any legislative intervention. However, regulation should not interfere with the methodologies of ratings. A variety of different approaches to methodologies can be of added value to investors, as long as it is crystal clear what the rating portends to assess. This is relevant in particular with regard to the vast difference between ESG ratings that asses risks to the rated company, and ESG ratings that assess the impact on sustainability by the assessed company.

Specific requirements on internal controls and governance should be laid down to ensure reliability and quality of the services provided and proper management of potential conflicts of interest. These governance requirements should, among other things, ensure that a consistent, timely, and knowledgeable application of ESG rating methodologies is applied by providers. Such core requirements should also be periodically reviewed taking into account market developments and, where appropriate, complemented by additional measures.

The AFM assessed different regulatory options to tackle the issues in this important market, spanning the spectrum from taking no action at all to a compulsory legislative framework at European level. The AFM believes that a European mandatory framework, consisting of an ad hoc regulation is the best approach and that ESMA should be entrusted with the authorisation and supervision of providers of ESG data, ratings and related services. This would ensure uniform supervision of the providers. Indeed, the AFM is of the view that this is preferable to supervision by national authorities, since providers and clients generally operate on a cross-border basis. Authorisation and supervision by ESMA would guarantee a harmonised application of rules as well as uniform supervision. Besides, ESMA staff would be able to leverage on the experience gained from the supervision of credit ratings agencies and trade repositories. Finally, if ESMA becomes competent for the authorisation and supervision of verifiers of green bonds, as is currently envisaged, it would be consistent that it also regulates providers of ESG data, analysis and services providers.

The AFM is also convinced that all the issues identified in this consultation must be analysed more globally than just at the perimeter of ESG ratings insofar as the problems identified are common to the various products offered by these players. Cases and scandals that have gradually come to light also do not only concern ESG ratings and confirm the need to address the wide range of products offered. Limiting the scope of any EU intervention to ESG ratings would also create a high risk of circumvention, similar to IOSCO's observation in its October 2017 report on Other CRA products for credit ratings. The AFM is also of the view that the scope should cover the diversity of ESG-related products/services since risks in the market for ESG products providers apply not only for ESG rating services, but also for the related services such as the provision of ESG data, scorings, controversies, scenario analysis, taxonomy-related tools, and screenings. The scope of the regulation should be well-calibrated to take into account the innovation and the diversity of products offered; articulation with other regulated statuses should also be carefully assessed.

The provision of ESG data needs in particular to be included in the scope of this regulation. Regulatory reliance exists especially in this area, as market participants rely for a large part on this data to fulfill their disclosure requirements as stipulated in the SFDR and Taxonomy regulation. Moreover, this data is the very root of all ESG-related analysis and services used by market participants and evidence exists of the important impact of such data in the ESG analysis and, as a consequence in all investment products and decisions they compose or inform. Transparency on the methodologies used and the origination of the data, is therefore essential for these services. Failure to provide such transparency, and therefore to guarantee the reliability of the services provided, would weaken the whole system.

69. 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

70. 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). providing clarity on the underlying data and data sourcing; Providing information on particular ESG standards used and whether and

how the products refer to the European taxonomy; Ensuring transparency on whether providers of ESG data, analysis and services have/hold dialogues with the companies which are the object of their analysis and with the stakeholders of the company.

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

In the 2020 position paper, the AFM and the AMF describe what a European regulation of ESG data, products and services providers could look like. The AFM considers the proposals formulated to be a starting point setting up core requirements for the regulation of ESG data, ratings and services providers. It should be periodically reviewed taking into account market developments and, where appropriate, complemented by additional measures.

Providers that wish to provide services to European companies should be subject to authorisation and supervision by ESMA, and should be required to operate through an establishment located in the European Union to ensure proper enforcement of any regulation. The scope of such regulation should be well-calibrated to take into account the innovation and the diversity of products offered; articulation with other regulated statuses should be carefully assessed.

- Without interfering in methodologies, the AFM believes that more granular information should be provided in the descriptions of methodologies and models (including information on criteria, selection and weighing factors, metrics and proxy used). In this regard, Annex III of Regulation (EU) 2019/2089 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks could provide a suitable source of inspiration. Sufficient transparency should also be ensured as regards the frequency and procedure of revision of the methodologies. Organisational and operational requirements should also be provided for in this area: a review function responsible for periodical review of the provider' methodologies, models and key rating assumptions, and any significant changes or modifications thereto as well as the appropriateness of those methodologies, models and key rating assumptions should in particular be required;

- The AFM believes that transparency requirements should cover the description of the products offered and their characteristics, in particular if they retain a sustainability risk or sustainability impact approach and whether or not the providers rely on particular ESG standards and whether and how they refer to the European taxonomy for some of their products;

- As regards the underlying data, the following information should in particular be requested : Main source of raw data used or marketed; Processes in place for collecting data; How the/an absence of reported data is managed (no data implemented, absence of data supplemented through: use of peer analysis, data approximation); Controls in place to ensure that the data is reliable, verifiable, up to date and comes from reliable sources; Appropriate organisational and operational functions should be implemented.

- To ensure an appropriate level of information on the possible interactions with analysed companies : whether providers of ESG data, analysis and services have/hold dialogues with the companies which are the object of their analysis and with the stakeholders of the company, and, if so, the extent and nature thereof; such transparency provisions could be inspired by the proxy advisors' regime introduced by Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement (SRD II, Article 3j); An obligation to establish a right of recourse for issuers whose data are used for the provision of ESG data, ratings and services should also be required , in order to offer issuers the right to check, if they so wish, the accuracy of the data used by the provider. In doing so, providers should ensure that the way they implement this obligation does not generate possible situations of conflicts of interest. Sufficient publicity should also be ensured for such interactions; any recourse taken by an issuer and corrective action taken should be made public.

- Policy in place regarding the prevention and management of potential conflicts of interest should be described, the activities of subsidiaries and parents companies should also be taken into account where relevant. Establishment of an appropriate and effective organisational and administrative arrangements to prevent, identify, eliminate or manage and disclose any conflicts of interest should be provided for.

- Fees: entities should ensure that fees charged to their clients for the provision of sustainability-related products/services are not discriminatory. Fees charged for rating services should not depend on the level of the ESG ratings issued by the providers or on any other result or outcome of the work performed. The regulation could also provide for the Commission, in close cooperation with ESMA, to prepare a report on how fees charged evolve over time.

72. If you responded 'other' to the previous question, please specify the other elements the intervention should focus on

Answer included in the previous question

73. 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

74. Please explain why :

Providers that wish to provide services to European market participants should be subject to authorisation and supervision by ESMA, and should be required to operate through an establishment located in the European Union.

In order to ensure a sound enforcement of the rules and to guarantee that issuers and investors may efficiently interact with the providers, the AFM believes that the supervisory regime should require ESG product providers who wish to provide services for European clients to have a permanent establishment in the European Union. The establishment in the EU is indeed the only way for the European regulator to exert its supervisory powers. Such an obligation should not constitute a major obstacle since the 2020 AMF analysis identified that two thirds of the analysed providers operating in the EU already have such an establishment in the EU27. The AMF-AFM position paper also developed the view that this supervisory regime should equally include a requirement for European clients who wish to make use of these services, to use only authorised actors, with a view to preserve the level playing field.

A proportionality regime should be inserted in this regulation and could in particular concern the obligation to operate through an EU establishment. The economic model of many smaller providers remains fragile and it is important to maintain a diversified offer. Proportionality could be achieved on a case-by-case and exceptional basis, as long as the provider is able to demonstrate that the requirements are not proportionate in view of the nature and scale of its business. The regulation should not by definition preclude continued access for European market participants to smaller providers operating outside of the EU, for whom a European establishment would be too burdensome. In such cases, a requirement to register with ESMA should still apply, in order to maintain a level playing field and allow for enforcement of the EU rules.

The AFM is of the view that ESMA should be entrusted with the authorisation and supervision of providers of ESG data, analysis and services. The authorities believe that this is preferable to regulation by a national authority since providers and clients generally operate on a cross-border basis. Authorisation and supervision by ESMA would guarantee a harmonised application of rules as well as uniform supervision. Besides, ESMA staff would be able to leverage on their experience gained from the supervision of credit ratings agencies and trade repositories. Finally, if ESMA becomes competent for the authorisation and supervision of verifiers of green bonds, as is currently envisaged, it would be consistent that it also regulates providers of ESG data, analysis and services providers.

75. 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

76. Please explain why

The provision of ratings or related services to market participants outside of the EU, even if the rated companies are based in the EU, should not be subject to authorization or registration in the EU, if only because such cases any legislative requirements cannot be enforced.

Rather, providers of ESG ratings or data should be subject to authorization or registration in the EU when they provide services to EU investors or issuers, while applying proportionality for smaller providers.

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

- Yes
- No
- No opinion

78. Please explain why

Defining transparency standards on methodologies should help increase comparability of providers' methodologies while leaving the latter with a large degree of flexibility in designing those methodologies. Without interfering in methodologies themselves, the AFM believes that more granular information (including information on criteria, selection and weighing factors, metrics and proxy used) should be provided in the descriptions of methodologies and models. Transparency should also be ensured on availability and processing of data as well as data estimation; providers of ESG data, ratings and services should clarify the sources of the information they collect (e.g. use of public information and/or questionnaires sent to companies and/or meetings with rated entities and/or the future European database) as well as the proportion of estimates used and how those estimates have been calculated. In this regard, Annex III of Regulation (EU) 2019/2089 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks could provide a suitable source of inspiration.

A lack of transparency indeed increases the risk of mismatches between the expectations of the investor and actual ESG performance of the investment. A related risk is that the opaqueness of services such as ESG ratings could be exploited to present a given investment as 'greener' than it actually is (greenwashing). Aside from investor protection risks, ensuing misallocation of investments poses a serious risk to the objectives of the Commission to channel sufficient private investment to the transition towards a climate-neutral economy.

More generally, the AFM and the AMF described in their joint position paper a certain number of transparency requirements to be implemented when regulating this market. These include in particular the following information:

- Description of the products offered and their characteristics;
- Main source of raw data used or marketed;
- Processes in place for collecting data;
- How the/an absence of reported data is managed (no data implemented, absence of data supplemented through: use of peer analysis, data approximation);
- Controls in place to ensure that the data is reliable, verifiable, up to date and comes from reliable sources;
- Whether providers of ESG data, analysis and services have/hold dialogues with the companies which are the object of their analysis and with the stakeholders of the company, and, if so, the extent and nature thereof;

- Whether or not the providers rely on particular ESG standards and whether and how they refer to the European taxonomy for some of their products;
- The frequency and procedure of revision of the methodologies; and,
- Policy in place regarding the prevention and management of potential conflicts of interest.

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

- Yes
- No
- No opinion

80. Please explain:

The AFM supports the development of transparency standards regarding methodologies. This regulation should however not interfere with the methodologies themselves as this could halter innovation and development of the sector. A variety of different approaches to methodologies can be of added value to investors, as long as it is crystal clear what the rating portends to assess. Transparency on the methodologies should increase the understanding of the ESG ratings which will help increase the comparability while leaving the providers with a large degree of flexibility in developing those methodologies.

Templates for disclosing information on methodologies could aid comparability, but needs to be developed jointly with users of this information to make sure it is worthwhile.

The transparency requirements identified in the AMF-AFM position paper could serve as input for such work.

81. 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

82. 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

83. If you responded 'other metric(s)' please explain which one(s):

The AFM supports the inclusion of a proportionality regime to safeguard innovation and plurality of providers. The AMF-AFM position paper indeed highlighted the fact that the economic model of many smaller providers remains fragile and it is important to maintain a diversified offer.

Aside from revenue, the number of companies that are being rated or the number of companies whose ESG data is provided, could serve as metric to differentiate larger providers from smaller ones.

Regulating entities that are based outside of the EU and do not offer their services to EU investors or issuers does not seem feasible. Regulation for such providers cannot be enforced, nor is there good reason to apply such regulation to such entities.

84. 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

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

86. If you responded 'other metric(s)' please explain which one(s):

b) Costs of an EU intervention

87. Questions for ESG rating providers

88. Assume that in order to offer services to investors in the European Union or to rate European companies/financial products, ESG rating providers would be subject to an authorisation or registration requirement. How high would you estimate the oneoff cost of applying for such an authorisation/registration? (please provide an estimate in EUR)

89. In order to increase transparency, there may be considerations to introduce disclosure obligations on ESG rating providers. This could include, for example, disclosures on websites or annual reports on the operations and methodologies used by ESG rating providers and/or providing more information on how these

methodologies were applied to specific ratings. Please estimate the number of hours needed to produce the following disclosures:

90. **If you chose more than 160 hours in the table above, please provide an indication of how many hours would be needed (for the costs in each column, as applicable). You may also use the following comment box if you wish to provide any further explanations.**

91. **What percentage of these costs would be incurred even in the absence of legislation?**

92. **Do you see any other costs related to providing these disclosures (e.g. adjustment of IT systems, external consultants, etc.)?**

93. **If yes, please specify what type of cost and provide an estimate of its amount where feasible:**

94. **How many hours per week would you consider necessary to perform tasks that would be linked to fulfilling ongoing supervisory requirements?**

95. **If more than 40 hours, please provide an indication of how many hours would be needed:**

96. **If there were similar conflict of interest provisions introduced for ESG rating providers as in Article 6 and Annex I to Regulation (EU) 1060/2009 (CRA regulation), would you consider the associated costs to be of similar magnitude?**

97. **Please explain**

98. **Do you expect that you would face any further costs as an ESG rating provider as a result of a possible legal framework besides those mentioned above?**

99. **If yes, please explain what types of costs, whether they would be one-off or ongoing and provide estimates if possible:**

100. Do you estimate that possible additional compliance costs implied by a minimum requirement framework for ESG ratings would be compensated by the benefits of higher quality and more reliable ratings?

101. What other impact(s) of a regulatory and supervisory framework on the operations of ESG rating providers would you see (e.g. potential impacts on competition, SMEs assessed by ratings, users of ratings, sustainable development)?

Questions for supervisors

102. How many hours of work would you consider necessary to perform tasks that would be linked to granting an authorisation for one ESG rating provider?

- Negligible time
- Less than 5 hours (but not negligible)
- 5 to 9 hours
- 10 to 19 hours
- 20 to 40 hours
- More than 40 hours

103. If more than 40 hours, please provide an indication of how many hours would be needed

The AFM has no indication regarding the number of hours necessary to perform the tasks linked to the granting of an authorisation for one ESG rating provider but instead utilizes this comment box to comment on the optimal implementation of supervision of ESG data, rating, and related service providers.

The AFM is of the opinion that ESMA should be entrusted with the authorisation and supervision of providers of ESG data, analysis and services in order to ensure a sound enforcement of the rules and to ensure that issuers and investors may efficiently interact with these providers. This is preferable to supervision by national authorities since providers and clients generally operate on a cross-border basis and some juridisctions may have to supervise only one or a few entities, hampering the efficient build-up of expertise and risking higher supervisory costs . Authorisation and supervision by ESMA would guarantee a harmonized application of rules as well as uniform supervision. Additionally, ESMA staff would be able to leverage on their experience gained from the supervision of credit ratings agencies and trade repositories. Finally, if ESMA becomes competent for the authorisation and supervision of verifiers of green bonds, as is currently envisaged, it would be consistent that it also regulates providers of ESG data, analysis and services providers.

The AFM would also like to recall that ESMA directly suggested such centralized supervision in its January 2021 letter to the European commission on ESG ratings.

104. How many hours per week would you consider necessary to perform supervisory tasks per ESG rating provider?

- Negligible time
- Less than 5 hours (but not negligible)
- 5 to 9 hours
- 10 to 19 hours
- More than 20 hours

105. If more than 20 hours per week, please provide an indication of how many hours would be needed

The AFM has no indication regarding the number of hours necessary to perform the tasks linked to the granting of an authorisation for one ESG rating provider but instead utilizes this comment box to comment on the optimal implementation of supervision of ESG data, rating, and related service providers. The AFM is of the opinion that ESMA should be entrusted with the authorisation and supervision of providers of ESG data, analysis and services in order to ensure a sound enforcement of the rules and to ensure that issuers and investors may efficiently interact with these providers. This is preferable to supervision by national authorities since providers and clients generally operate on a cross-border basis and some juridisctions may have to supervise only one or a few entities, hampering the efficient build-up of expertise and risking higher supervisory costs . Authorisation and supervision by ESMA would guarantee a harmonized application of rules as well as uniform supervision. Additionally, ESMA staff would be able to leverage on their experience gained from the supervision of credit ratings agencies and trade repositories. Finally, if ESMA becomes competent for the authorisation and supervision of verifiers of green bonds, as is currently envisaged, it would be consistent that it also regulates providers of ESG data, analysis and services providers. The AFM would also like to recall that ESMA directly suggested such centralized supervision in its January 2021 letter to the European commission on ESG ratings.

PART B – INCORPORATION OF ESG FACTORS IN CREDIT RATINGS

The provision of credit ratings is highly regulated in the EU as well as globally. Global standards are established by the IOSCO in its code of conduct for CRAs. The EU legal framework regulates the activities of CRAs with a view to protect investors and financial markets by guaranteeing the transparency, independence and integrity of the credit rating process – thereby enhancing the quality of ratings. All CRAs operating in the EU need to register with ESMA, which is the sole European supervisor. Credit ratings used for the purposes stemming from the EU legislation need to be provided by CRAs registered and supervised by ESMA. If a non-EU CRA wants its ratings to be used for regulatory requirements in the EU (i.e. by EU financial institutions), the CRA Regulation provides for two alternatives, certification or endorsement.

There are a number of EU regulatory requirements related to the use of credit ratings. , in particular, in the Capital Requirements Regulation (CRR) and in the Solvency Capital

Requirement (SCR). The European Central Bank also makes extensive use of credit ratings in its open market operations.

Both EU legislation[1] and the IOSCO code of conduct define precisely the objective of the credit rating: 'credit rating means an opinion regarding the creditworthiness of an entity, a debt or financial obligation, debt security, preferred share or other financial instrument, or of an issuer of such a debt or financial obligation, debt security, preferred share or other financial instrument, issued using an established and defined ranking system of rating categories'.

In other words, credit ratings assess the likelihood of the default of the rated entity or security. Credit ratings reply to the question: "what is the likelihood of getting my money back?" They are neither investment recommendations nor they determine the value of the rated entity or instruments.

ESG risks may be relevant for the assessment of creditworthiness depending on the sector, geographical location and the entity itself. CRAs methodologies define which factors, including ESG factors, are considered to be relevant for the assessment of creditworthiness and how they are taken into account in the credit rating process. ESMA supervises the soundness of methodologies, which in accordance with the CRA Regulation need to be rigorous, systematic, continuous, based on historical experience and back-tested. In its Technical Advice provided to the Commission in 2019, ESMA concluded that while it is clear that CRAs are considering E, S or G factors in their credit ratings, the extent to which each factor is considered varies by asset class, according to the importance assigned to that factor by a CRA's methodology. Currently, ESMA is conducting a thorough assessment of how CRA's methodologies incorporate sustainability risks.

The CRA Regulation includes a number of disclosure obligations in relation to the methodologies as well as individual credit ratings. In 2019, ESMA conducted a public consultation on disclosure requirements applicable to credit ratings. Following the finding on the insufficient transparency on the relevance of ESG factors to credit ratings, one of the topics of the consultation, ESMA issued guidelines on disclosure requirements applicable to credit ratings.
These ESMA guidelines expect CRAs to identify in their press releases if ESG factors have been key drivers behind a change in the credit rating. CRAs are asked to identify relevant factors, elaborate on their materiality and provide a reference to the methodology or the associated model. The ESMA guidelines came into effect in April 2020.

A recent assessment of the application of the guidelines revealed that the improvement of transparency has been partial. ESMA has analysed press releases over the period January 2019 – December 2020 and compared the number of references to ESG considerations before and after April 2020. The main findings are that the improvement is partial and not uniform.

This consultation builds on the findings of ESMA and the consultation on renewed sustainable finance strategy.

[1] Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies, https://eur-lex.europa.eu/legalcontent/EN/TXT/?uri=CELEX:32013R0462

I. Questions to users of credit ratings

106. Do you use credit ratings for investment decisions?

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

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

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

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

110. Please explain

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

112. If you responded 'other' please explain where:

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

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

115. 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)

116. 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.

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

II. Questions to Credit Rating Agencies

118. Do you explicitly incorporate ESG factors in your methodologies?

119. Please explain your reply

120. Which individual E, S and G factors do you consider in your methodologies? (multiple choice)

121. Please explain in more details

122. In addition to methodologies, do you have a framework or a document describing how you incorporate ESG factors in the credit rating process? By framework, we mean any general approach to the incorporation of ESG factors in credit rating process, in addition to methodologies for asset classes and sectors.

123. If you answered other, please explain

124. Have you improved disclosure on ESG factors in credit ratings since April 2020 when ESMA guidelines became applicable?

125. If you replied no to the previous question, please explain why

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

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

127. 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?

128. If you responded 'no' to the previous questions, what type of intervention would you consider necessary? (multiple choice)

129. If you responded 'other' to the previous question, please specify the other type of intervention you consider necessary:

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

131. If you responded other, please explain:

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

133. If you responded 'others', please explain:

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

Costs of EU intervention - questions for CRAs

135. Where applicable, what are your costs in EUR to disclose information based on the current Guidelines on disclosure of ESG factors in credit ratings?

136. Would you foresee any additional compliance costs if the current Guidelines on disclosure of ESG factors in credit ratings were to become part of the EU legislation?

137. To what degree do CRAs overall already follow the guidelines in the absence of an obligation to do so?

138. Would you expect additional compliance costs if EU legislation explicitly required CRAs to take into account ESG factors where relevant in the rating process?

139. If you do expect additional compliance costs, how high would you expect these additional costs, as compared to current practice?

140. Please explain