To

European Commission
DG FISMA
Financial Markets
Corporate reporting, Audit and Credit Rating Agencies

Submitted via web

Date: June 8th, 2022

Reference: Targeted Consultation on the Functioning of the ESG Ratings Market in the European Union and on the Consideration of ESG Factors in Credit Ratings

Dear European Commission,

With reference to the above targeted consultation, we are pleased to hereby submit the views of our association representing European Credit Rating Agencies registered with ESMA.

We very much welcome the very detailed consultation on the ESG rating market and on ESG factors in credit ratings. Since a high number of questions are addressed to users of ratings and companies subject to ESG ratings, we hereby provide our general views on both sections of this consultations only.

Part A – ESG Ratings

We agree that the market for ESG ratings has substantially increased in recent years, driven amongst others by high investors demand for these products. Depending on the type of investors (screening of investments, passive investor, impact investors), investors may use ESG data, ESG research or ESG assessments differently. In recent years, we note that the number of ESG assessment providers has substantially increased and that several established players have been taken over by registered Credit Rating Agencies.

The consultation paper cites on page 4 the results of a study on sustainability related ratings, data and research, which we recall here: "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. (…) Stakeholders indicated that better comparability and increased reliability of ESG ratings would enhance the efficiency of this fast growing market".

We agree with the above analysis and believe that these concerns would be best addressed by regulating this industry. A clear regulatory framework will benefit users of ESG assessments, entities being assessed and ultimately ESG assessments providers.

Given that ESG assessments are often referred to as ESG ratings, we recommend a legislative proposal targeting the registration and supervision of ESG rating providers so that all entities providing ratings (ESG rating providers and Credit Ratting Agencies) would adhere to similar regulatory and supervisory requirements.

In view of the EU Green Deal, we think that an European approach towards ESG rating providers is the right approach. The CRA Regulation in Europe may serve as a great benchmark for regulating ESG rating providers.

As ESMA registered Credit Rating Agencies already need to adhere to a strict regulatory and supervisory framework with regard to rating methodologies, conflict of interest (etc), we propose that Credit Rating Agencies providing stand-alone ESG assessments should have the opportunity to "opt-in" into such a new legislative framework on ESG rating providers with a lighter registration process.

Part B "Incorporation of ESG Factors in credit ratings"

With respect to the questions addressed to Credit Rating Agencies, we think that CRAs integrate to a differing level ESG factors in their rating methodologies and credit ratings as each CRA serves different market, asset classes and users of ratings. As an association, we therefore retain from commenting on these topics and refer to the individual responses of Credit Rating Agencies.

In July 2019, ESMA adopted the final guideline on "disclosure requirements on CRAs"[1], which entered into force end 2020. We hereby would like to recall two important elements of this guideline regarding ESG factors in credit ratings: ""Where ESG factors were a key driver behind a change to a credit rating or rating outlook, (…) the CRA should explain why these ESG factors were material to the credit rating or rating outlook". We believe that this approach is very meaningful and appropriate under the current circumstances:

- Credit ratings primarily focus on the credit quality of an issuer over the medium term (usually 3 to 5 years). ESG risks may have a far longer time horizon to materialize and may therefore not necessarily impact on a medium-term credit rating

[1] Available at: https://www.esma.europa.eu/sites/default/files/library/esma33-9-320_final_report_guidelines_on_disclosure_requirements_applicable_to_credit_rating_agencies.pdf

- ESMA retained from requesting CRAs to systemically include information on ESG risks in press releases but instead included the above approach focusing on key drivers having a material impact on credit ratings.

In February 2022, ESMA published a report on “text mining ESG disclosures in rating agencies press release”[2]. According to the accompanying press release, ESMA found “that the overall level of disclosures has increased since the introduction of the Guidelines, but that a high level of divergence across CRAs means there is still room for further improvement”. We note that ESMAs study related to press release for the year 2020, so covering only a short period of time where the guidelines where applicable.

With respect to integrating ESG factor into CRA rating methodologies, we first need to recall the important principle embedded in Article 23 of the CRA Regulation stating that “in carrying out their duties under this Regulation, ESMA, the Commission or any public authorities of a Member State shall not interfere with the content of credit ratings or methodologies”.

Article 8 (3) of the CRA Regulation states the following requirements on rating methodologies: “A credit rating agency shall use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back-testing.” We believe that currently ESG data are not available in a consistent manner in order to carry out a full back-testing on a systematic basis.

Given the numerous initiatives of the European Union in the field of sustainable finance (e.g. Taxonomy, Green Bonds, Corporate Sustainability Reporting Directive), we believe that in the medium-term the availability of ESG data will substantially increase. But, in order to back-text this new information set, CRAs will require at least 3 to 5 years of data. We therefore believe that the current ESMA guideline on CRA disclosure strikes the right balance and that any additional measures are still premature.

We thank you for your kind attention and remain at your disposal for any clarification or additional information.

About EACRA

The European Association of Credit Rating Agencies (EACRA), set up in November 2009 and registered in Paris, was established to act as a platform for cooperation for EU-based Credit Rating Agencies (CRAs). Our mission is to support and facilitate the compliance of CRAs with regulatory requirements through effective communication, cross-border know how, and the promotion of best practices. In addition, EACRA seeks to promote Credit Ratings and the interests of CRAs across Europe, as well as enhance the financial community and general public’s understanding of Credit Ratings.

[2] Available at : https://www.esma.europa.eu/sites/default/files/library/esma80-195-1352_cra_esg_disclosures.pdf