

CONSULTATION RESPONSE

ESMA CALL FOR EVIDENCE ON MARKET CHARACTERISTICS FOR ESG RATING PROVIDERS IN THE EU

11 March 2022

INTRODUCTION

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI is a not-for-profit company with over 4,700 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles, with approximately US \$121 trillion in assets under management.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

The PRI welcomes the opportunity to respond to the European Security and Markets Authority (ESMA) call for evidence on market characteristics for ESG rating providers in the EU.

ABOUT THIS CONSULTATION

On 3 February 2022, ESMA published a call for evidence on market characteristics for ESG rating providers in the EU. The consultation seeks feedback from ESG rating providers and their users with the aim of developing a picture of the size, structure, resourcing, revenues, and product offerings of the different ESG rating providers operating in the EU.

It is expected that this consultation from ESMA will be followed by another complementary consultation on ESG ratings from the European Commission (as announced in its [sustainable finance strategy](#) in July). The European Commission consultation is expected to cover the use of ESG ratings by market participants and the functioning and dynamics of the market, potential issues, and potential costs of an intervention at EU level.

This consultation response focuses on Questionnaire B for Users of ESG Rating Providers.

For more information, contact:

Elise Attal

Head of EU Policy

Elise.attal@unpri.org

René Van Merrienboer

Acting Director of Sustainable Markets

Rene.van-merrienboer@unpri.org

KEY RECOMMENDATIONS

The PRI welcomes increased attention by regulators such as ESMA to the market for ESG ratings and data products and the providers of these products, given the important role these products play in investment processes. The market for ESG ratings and data has experienced considerable growth and consolidation in recent years. Demand for these products and services is only likely to keep growing in the future, given investors' accelerating interest in ESG and sustainable investing and as they increasingly face mandatory ESG disclosure requirements¹.

In light of these developments, supervisory authorities should consider regulatory action to enhance the functioning of the market for ESG ratings and data products. The PRI recommends that regulators focus their attention on the following:

- Improving transparency by ESG ratings and data products providers on their methodologies and processes, by developing minimum quality and transparency standards, and ensuring that data coverage gaps are addressed.
- Ensuring that ESG ratings and data products providers have appropriate governance arrangements in place, that they have rigorous conflicts of interest management policies and that they prioritise the independence and integrity of their research and offerings (with greater clarity on whether and how the rated issuer perspective is included into the rating and engaged by the provider).

However, any reforms should be proportionate and allow for market innovation. We encourage regulators to continue to work with investors and providers to determine an appropriate approach.

In addition, the PRI recommends accelerating the reforms towards mandating corporate reporting standards and disclosures of key underlying ESG data. We welcome global and regional efforts by regulators to improve the reliability, consistency, and comparability of corporate ESG reporting standards and disclosures. These efforts are crucial to increase the availability and quality of ESG data, and by extension the quality of ESG ratings and data products, as both investors and providers need decision-useful, timely and standardised corporate disclosure. We note the proposal for a European Single Access Point (ESAP) which should improve investor access to ESG data and facilitate investors' disclosure obligations.

The PRI acknowledges that investors have the responsibility to understand the intended purposes and the methodologies of ESG ratings and data products and should determine whether these are suitable for the purpose for which they are being used in the investment process.

¹ According to a position paper by the [AFM and AMF](#), the ESG data and services market could reach a value of over US\$5 billion by 2025 (Position Paper: Call for a European Regulation for the provision of ESG data, ratings, and related services).

DETAILED RESPONSE

6.2.1 – Background information

Please see the introduction for background information about the PRI.

The PRI is responding to this consultation because of the important role that ESG ratings, data products and their providers play in investment processes, and given the increasing demand for these products and services.

Q1: Name of respondent or organisation (including Legal Entity Identifier).

PRI Association.

Q2: Nature of establishment in EU

- ~~A. Legal entity established in EU~~
 - ~~e. Please indicate Member State(s) of legal entities~~
- ~~B. Legal entity and corporate headquarters established in EU~~
 - ~~e. Please indicate country of corporate headquarters~~
- ~~C. No legal entity or corporate headquarters established in EU~~
 - ~~e. Please indicate country of corporate headquarters~~
- D. Other
 - o Please explain

The PRI Association is headquartered in the UK.

The PRI works with over 1500 signatories based in the EU. Many of these signatories are users of ESG ratings (asset owners and investment managers) and some are ESG rating providers. The PRI is therefore keen to contribute to regulatory developments, where relevant, by providing expertise and examples of best practice in the market.

For more details on the PRI's policy approach, [please see here](#).

Q3: Respondent subject to any existing financial regulatory authorisation, registration or supervisory regime.

- ~~A. Yes~~
 - ~~a. Please provide further details of regime including name of authorisation, registration, or supervisory body and reference to supporting legal acts.~~
- B. No

The is not applicable to the PRI.

Q4: General description of business model and main area of economic activity.

Please see the introduction for a general description of the PRI's business model and main area of economic activity.

Q5: Estimated total value (in EUR) of administrated assets and/or asset under management (if applicable).

This is not applicable to the PRI.

Q6: Estimated total value (in EUR) of investments for which ESG rating and/or other ESG data products are used as input in investment decision making process (if applicable).

This is not applicable to the PRI.

6.2.2 Use of ESG ratings (if applicable)

Q1: Currently contracting for ESG ratings

~~(A) Yes~~

(B) No

Q2: Currently contracting for other ESG data products

~~(A) Yes~~

(B) No

These questions are not applicable to the PRI.

Q3: If yes to Q1 or Q2, please list the providers you contract with for each ESG rating and/or other ESG data products and identify the categories of product.

These questions are not applicable to the PRI.

Q4: Please provide the length of time in months which you have contracted with each provider.

This is not applicable to the PRI.

Q5: Please explain reason behind the choice of the ESG rating or data provider(s) listed in Q3.

This is not applicable to the PRI.

Q6: Please explain reason for choosing more than one ESG rating provider (if applicable).

This is not applicable to the PRI.

Q7: In case you changed ESG rating provider, please provide the rationale behind the choice.

This is not applicable to the PRI.

Q8: Please outline and explain any shortcomings in the ESG rating or ESG data products you currently contract for.

This is not applicable to the PRI.

Q9: Please outline whether you are satisfied with the level of methodological transparency for the products you contract for, including transparency around data sourcing.

This is not applicable to the PRI.

Q10: If no to Q1 and Q2, please list ESG rating and/or other ESG data products providers you are currently using.

This is not applicable to the PRI.

Q11: Please outline and explain any shortcomings in the ESG rating or ESG data products you are currently using on a non-contractual basis.

This is not applicable to the PRI.

Q12: Please outline whether you are satisfied with the level of methodological transparency for the products are currently using on a non-contractual basis.

This is not applicable to the PRI.

6.2.3 Contractual Characteristics

Q1: If you currently contract for ESG rating or ESG data products, please briefly describe the terms of use of your ESG rating provider, including:

- **Time horizon of the contract**
 - **Please provide details of break clauses and frequency of renewal.**
 - **Products included in contract**
- **Please outline if the contract covers a single product offering or a package of product offerings.**
- **Please outline if products were available only under the form of packages of multiple service and/or products.**
- **Please provide a more specific description of the products including their intended area of focus.**
- **The Fees structure for contracted products**
- **Please outline if there is a flat fee for each product offering, or discount for bundled offerings.**
- **Please outline the main characteristics of the fee structure, including frequency and transparency of revisions.**
- **Any usage limitations (e.g. use of ratings, access to ESG ratings, time restrictions, others).**

- Please outline if there are any usage limitations placed on the products which are contracted for, for example, ability to disclose or share with third parties.

This is not applicable to the PRI.

6.2.4 General views on ESG ratings in EU Financial Markets

Q1. Please provide your views on the level of relevance of ESG ratings to EU financial markets and financial market participants. Do you consider this level will increase in the coming years?

ESG ratings and data product providers deliver an important service to investors. They provide information to investors to understand, measure and manage ESG risk and opportunity. In that way, their corporate ESG performance analysis bring valuable addition to investors' portfolio analysis and investment decision-making.

The PRI supports increased attention by regulators such as ESMA to the market for ESG ratings and data products and the providers of these products and notes the findings in the recent IOSCO report² on ESG ratings and data products providers. The strong growth of responsible investment practices has led to a steep increase in the demand for ESG data and related products and services. Almost all investors now use third party providers for obtaining at least some of their ESG data and analysis, and some investors even rely on externally processed data and other resources like ESG scores.³

Although large investors are increasingly developing in-house metrics to better capture ESG risks and opportunities and sustainability performance within their investment processes, third-party providers will continue to play an important role by providing more tailored services, such as data modelling and analytics, and bespoke data feeds. As intermediaries between corporates and investors, they are an essential component of the sustainable investment chain, and the PRI believes their relevance to EU financial market and financial market participants will continue to grow due to the increased use of ESG ratings by both active and passive investment portfolios.

Investors holding active portfolios are likely to continue to use ESG ratings in the coming years to assess their portfolio selections and make informed decisions regarding their voting and engagement practices. However, passive portfolios also increasingly use ESG ratings. Following on from year-on-year growth since 2005, the EU is currently the largest market for ESG or sustainability focused passive investments, representing more than 75% of global assets in this category as at 2020⁴. ESG ratings play a key role in the methodology of a considerable proportion of these assets, predominantly through their impact on the exclusions and weightings assigned to companies in ESG-themed passive

² IOSCO 'Environmental, Social and Governance (ESG) Ratings and Data Products Providers' [FR09/2021 Environmental, Social and Governance \(ESG\) Ratings and Data Products Providers \(iosco.org\)](https://www.iosco.org/FR09/2021%20Environmental,%20Social%20and%20Governance%20(ESG)%20Ratings%20and%20Data%20Products%20Providers%20(iosco.org))

³ See, for example, p.3 of the results from a PRI survey for fixed income investors on ESG information providers [Broadening the outreach to ESG information providers | Article | PRI \(unpri.org\)](https://www.unpri.org/Broadening%20the%20outreach%20to%20ESG%20information%20providers%20|%20Article%20|%20PRI%20(unpri.org))

⁴ 'Passive Sustainable Funds: The Global Landscape 2020', Morningstar, September 2020, p.10.

equity, and to a lesser extent fixed income, indices. Given the growing impact that ESG ratings have on investment allocations in the EU, the integrity of these ratings is paramount.

The PRI also notes the relevance of ESG ratings to the EU's Sustainable Financial Disclosure Regulation (SFDR). Specifically, SFDR Articles 8 and 9 will require investors to disclose how products pursuing ESG or sustainability objectives align to those objectives.⁵ In ESG-themed index products, for example, ESG ratings feature in the methodology of the benchmark and inform the ongoing assessment of the companies and issuers included. So, investors will rely on the accuracy of ESG ratings to evidence alignment with ESG objectives within these products. Therefore, the integrity of ESG ratings will influence the adequacy of investor reporting.

Q2. Please provide your views on the level of risk ESG ratings currently pose to orderly markets, financial stability and investor protection in the EU. Do you consider this level will increase in the coming years?

ESG ratings and data products play an important role in investment decision-making. The demand for, and influence of these products, is expected to increase in the coming years as investors continue to pursue ESG and sustainability objectives through their investments. It is therefore paramount that ESG ratings and data products are reliable, high quality and transparent. To ensure that ESG ratings do not interfere with orderly markets, financial stability and investor protection, the PRI notes the following areas for attention:

- The **availability of reliable, high-quality and up to date ESG data** is a critical component of ESG ratings and data products and determines to a large extent the quality of the products. Therefore, the lack of reliable, consistent, and comparable ESG reporting standards and poor disclosures from issuers impacts not only the availability and quality of information that can be used by investors, but also by ESG ratings and data products providers. Current global efforts, led by the International Reporting Standards Foundation (IFRS) to establish a global baseline for corporate sustainability reporting focussed on enterprise value creation, and regional developments that introduce or expand corporate ESG standards and disclosure requirements such as the EU's Corporate Sustainability Reporting Directive, can help to address this issue, and are particularly welcome. Regulators should continue to support these processes and work to align standards and disclosure requirements for corporates where possible.
- **Transparency of methodologies:** investors need to be able to understand an ESG rating's or data product's intended purpose and how its outputs are determined, to choose the product that best fits with their investment processes. In this context, investors have indicated that providers should improve their client communications in the event of changes to data or methodology⁶. In addition, improved transparency would not only help investors, but also make ESG ratings and

⁵ PRI report 'EU Regulation on sustainability-related disclosures in the financial services sector' [EU Regulation on sustainability-related disclosures in the financial services sector | Policy report | PRI \(unpri.org\)](#)

⁶ PRI research 'Do ESG information providers meet the needs of fixed income investors?' [Do ESG information providers meet the needs of fixed income investors? | Article | PRI \(unpri.org\)](#)

data products providers more accountable for how they verify and validate their data sources and metrics, including to regulators. This in turn can help to increase the reliability and quality of ESG ratings and data products.

- Furthermore, to enable investors to understand the underlying nature and basis of the ESG information – either in terms of the underlying data set and/or the methodology used to arrive at the evaluation or opinion – providers should disclose and clearly signpost data sources, distinguishing between whether an issuer’s information is public (either voluntary or mandatory) or generated by internal models and assumptions, and whether those are AI or non-AI derived. Investors also need more information on how data is updated, for example when data sources are discontinued, or historical data is revised.
 - If the underlying methodologies of the products are well explained and communicated, and the data sources are clear, investors can choose the offerings that best meet their investment processes. For example, some ESG ratings try to capture an issuer’s exposure to ESG risks and how prepared they are to manage these risks – how ESG ratings providers make such assessments should be better explained. This should also help the market better understand the reasons behind divergent ESG ratings from different providers.
 - Enhanced transparency of methodologies will also ensure that investors using ESG ratings to assess different asset classes are able to undertake analysis on the appropriateness of the rating for use in their particular investment strategy and/or analytical model. ESG-focused data, products and services have historically been tailored to meet the needs of equity investors. PRI research⁷ highlighted that fixed income investors utilise ESG ratings and data differently to equity investors, recommending that further transparency and customisation of methodologies is required to properly accommodate this market. The PRI’s ongoing work in this area also notes ongoing confusion by market participants regarding what is measured by ESG ratings versus credit ratings.⁸ Enhancing transparency of methodologies is an important step towards addressing such issues. Furthermore, even for those investors that carry out proprietary ESG assessments, it is important to have transparent methodologies for all ESG ratings’ providers so they can justify to clients why and where assessments may differ from third party providers’ ratings.
- **Coverage of markets and types of issuers:** ESG ratings and data product providers should acknowledge that high quality ESG data reflects more-readily available information in the investment-grade and developed markets. Consequently, providers should consider, where possible, reducing data coverage gaps by increasing and adapting the coverage of emerging

⁷ PRI research ‘Do ESG information providers meet the needs of fixed income investors?’ [Do ESG information providers meet the needs of fixed income investors? | Article | PRI \(unpri.org\)](#)

⁸ PRI ‘Statement on ESG in credit risk and ratings’ [Statement on ESG in credit risk and ratings \(available in different languages\) | PRI Web Page | PRI \(unpri.org\)](#)

markets and non-listed issuers in their products, subject to full transparency on data sources and methodologies.⁹

- **Governance and conflicts of interest:** to ensure the reliability of ESG ratings and data products, providers of these products should have adequate governance arrangements in place to identify, manage and mitigate any potential conflicts of interests that may occur because of the organisational structure of the provider, fee structures or intersecting business activities. Especially for ESG ratings, investors need to have assurance that an evaluation of a given company was not unduly influenced, for example due to the fee model ('issuer pays') or consulting services provided to that company by the same provider. The PRI notes ESMA's¹⁰ concerns regarding the conflicts-of-interest that may exist in traditional business models, such as credit ratings agencies, which are now offering ESG-related products and services. However, if proper governance mechanisms are put in place to ensure a separation of complementary business activities, these risks may diminish.

The PRI recommends that these points should be addressed with regards to the risks posed by ESG ratings and data providers to orderly markets, financial stability, and investor protection in the EU. However, the PRI takes the view that regulatory interventions should be proportionate and allow for market innovation when it comes to rating methodologies, without interfering with the methodologies themselves or impeding the independence and integrity of ESG research. They could also draw on past and existing voluntary standards for responsible investment research, such as ARISTA¹¹. We encourage regulators to continue to work with investors and providers to determine an appropriate approach.

⁹ 'The unintended consequences of sovereign ESG benchmarks', Jeroen Verleun, [Responsible Investor, September 17, 2020](#)

¹⁰ ESMA 'ESMA finds high level of divergence in disclosure of ESG factors in credit ratings' [ESMA finds high level of divergence in disclosure of ESG factors in credit ratings \(europa.eu\)](#)

¹¹ ARISTA is the Responsible Investment Research Standard, developed in response to the demands from global investors and companies for responsible investment (RI) research groups to incorporate the key principles of quality, integrity, transparency and accountability into their research processes: [2012_Press_release_ARISTA_3_0.pdf \(vigeo-eiris.com\)](#)

CONCLUSION

This response has set out the PRI's view of the ESG ratings market and the key risks that it faces, but we also acknowledge the importance of investor due diligence. Investors or other users of ESG ratings and data products should ensure they understand the intended purpose and methodology of the product, and to determine whether it is suitable for the purpose for which it is being used in the investment process.

Ultimately, investors decide on what ESG information and analysis is incorporated in their investment decisions and therefore bear the responsibility to ensure that any ESG ratings or data products used in the investment process are fit for purpose. However, this is also contingent on increased transparency by ESG ratings and data product providers on the methodologies of their products to enable investors to conduct this due diligence in full.

The PRI has experience of public policy on sustainable finance policies and responsible investment across multiple markets and stands ready to further support the work of ESMA to review the market characteristics for ESG rating providers in the EU.

Any questions or comments can be sent to policy@unpri.org.

PRI EU Transparency Register Number: 612289519524-31