International
Capital
Market
Association

21 June 2023

Response to the HMT's consultation on a future regulatory regime for Environmental, Social, and Governance (ESG) ratings providers

The International Capital Market Association (ICMA) welcomes the opportunity to provide feedback to the HMT on its consultation on a future regulatory regime for Environmental, Social, and Governance (ESG) ratings providers.

ICMA is a membership association, headquartered in Switzerland, committed to serving the needs of its wide range of members. These include private and public sector issuers, financial intermediaries, asset managers and other investors, capital market infrastructure providers, central banks, law firms and others worldwide. ICMA currently has over 620 members located in 66 jurisdictions. See www.icmagroup.org.

This feedback is given on behalf of ICMA's buyside members from the Asset Management & Investors Council (AMIC).

The response below has been directly submitted to ESGRatingsConsultation@hmtreasury.gov.uk

Yours faithfully,

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ICMA welcomes HMT's consultation paper (CP) on a proposed future regulatory regime for Environmental, Social, and Governance (ESG) ratings providers. We agree that ESG factors increasingly matter in financial markets as, among other, they serve investors such as asset managers and asset owners as guidance on their capital allocations. ICMA is also currently involved in the creation of a voluntary Code of Conduct for ESG Ratings and Data Providers.

Response to Q1:
We agree that regulation should be introduced for ESG ratings providers. However, we think that regulation should be extended to/introduced for ESG data providers.

ESG data is not only used as a component of ESG ratings but as a standalone product. Asset managers in their daily work are increasingly dependent on ESG data providers when it comes to, for example, their disclosure obligations under SFDR or commitments vis-à-vis their clients etc. Not being able to rely on good quality data for reporting or to make investment decisions, could result in sanctions of asset managers by authorities or prosecution by clients. **It is important that ESG ratings and data providers are covered by proportionate and balanced regulatory obligations**, as any other contributor to the (sustainable) investment value chain, accountable for their duties (from the reporting entities to asset managers).

Including ESG data providers in regulation would be consistent with IOSCO's recommendations which address both ESG ratings providers and ESG data providers and thus ensure that the whole ESG value chain would be covered by the ESG regulatory framework. This has also been acknowledged by the FCA, as mentioned in the proposal: *"the FCA has concluded it sees a clear rationale for regulatory oversight of certain ESG ratings and data providers when their products are used in financial markets".* Moreover, ESG data providers and ESG ratings providers are rarely separated in a concentrated market and even when they are, both would benefit from oversight and disclosure regarding their governance model, transparency of methodologies, management of conflicts of interest, etc.

With that in mind, it is not clear from the proposal, to which extent ESG data is already included after all, by HMT setting the term "rating" very broad: "*This proposal intends to include any assessments, regardless of their self-identification (i.e., whether they are called "ratings", "scores", "marks", or anything else, including where market participants currently consider these to be data products)".* This should be clarified and a definition of what constitutes an "assessment" be given.

Asset managers understand ESG data to encompass both raw data but also data including assessments or value judgements such as: estimates; data based on a provider's methodology (e.g. scope 3 emissions) and sectoral data (e.g. scope 1 and 2 emissions) where differences often result from data providers using different sector classifications. ESG data can therefore not be considered to be less processed than ESG ratings or that if left unregulated less risk of harm would arise from them.

Lastly, some asset managers would like both ESG ratings and data providers to be more transparent not only on their methodologies but also when it comes to fees. This would allow asset managers to better compare ESG ratings and data providers and evaluate the costs of the products and services they offer.

Response to Q3:
We do not see any risk of overlap with existing regulation. In contrast to other market participants such as asset managers, both ESG ratings and data providers currently do not have to comply with any ESG related regulation.

Response to Q6:
Asset managers disagree. As stated under Q1, HMT should define what it understands by "assessment" as often there is a difficulty to delineate between different activities. That said, ESG data that does not involve an "assessment" such as, for example, raw data, should be subject to the transparency aspect of any regulation.

With global initiatives such as ISSB standards and ESRS under way, accuracy of the ESG data reported from rated entities will become more standardised over time. However, even then, ESG ratings and data providers should provide transparency on how the data is collected (e.g. from public audited reporting or questionnaires sent to entities) and how often it is updated. Furthermore, providers should have processes, systems and controls in place to help ensure consistency and reliability in the data they collect and provide to users.

Response to Q10:
Asset Managers agree that these should be excluded from regulation. As per IOSCO's recommendations, any regulation should be aimed at services that are being marketed by ESG ratings and data providers. For the buyside, especially on paragraph 3.3., **the definition of ESG ratings should not include ESG assessments that asset managers develop and use internally (and intragroup) but focus on those that are commercially sold to third parties**.

Response to Q12:
Asset managers agree on the application of the regulation to non-UK rating providers if the users are based in the UK. However, entities which are not directly provided with / purchasing the ESG ratings or data (including, as mentioned above, the intra-group entities) should not be included as users in scope of the regulation.

Response to Q16:
Following the IOSCO Report, various global jurisdictions have either started working on regulation or codes of conduct. The regulator in Japan was the first to publish its Code of Conduct on both ESG ratings and data providers in December 2022 and as mentioned in the introduction, ICMA is currently involved in drafting a voluntary industry-led Code of Conduct which could be used internationally. The EU this month has also published a proposal on regulation of ESG ratings activities.

We would therefore encourage HMT to continue the dialogue with other jurisdictions (especially the EU) as, given the global nature of ESG ratings providers and uses, alignment on disclosures would further enhance the benefits of increased transparency. Depending on these developments, we agree that HMT should consider equivalent overseas regimes which should allow firms carrying out these activities to obtain authorisation without the need to have a physical presence in the UK.

Response to Q17:
Asset managers agree that smaller ESG ratings and data providers could be subject to fewer or less burdensome requirements. However, even smaller providers should have to comply with certain minimum requirements on authorisation where ESG ratings and data products are marketed to users.
The proposed opt-in mechanism should then only be available for requirements beyond the minimum requirements, where smaller providers would like to compete with larger providers.

Response to Q22:
We think a main outcome of any regulation should be improved transparency through certain disclosure requirements on, for example, methodologies as well as improved reliability through operational and internal control policies and processes. Furthermore, asset managers would like to see increased consistency and standardisation of how information is presented.