European Association
of Sustainable Rating Agencies

Press Release

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EASRA Position on ESG Ratings Regulation

In June 2023, the European Commission has issued a proposal to regulate the ESG Rating sector within the European Union, with the goal to prevent conflicts of interest, ensure rigorous and high-quality rating methodologies and create a higher degree of transparency on method and processes. The European Parliament as well as the European Council have recently concluded on their respective positions on the draft regulatory text, and the interinstitutional negotiations are about to proceed.

The members of the European Association of Sustainability Rating Agencies (EASRA)[1] are committed to promote transparency, rigour, independence and the principle of double materiality in ESG ratings and assessments. We share the conviction that future regulation can improve integrity and effectiveness of ESG rating activities, especially through establishing a level playing field that supports competition in the nascent market(s) for ESG ratings and ESG data. Many of the proposed elements and amendments will enhance the quality of ESG ratings, especially the rules enforcing stricter management of conflicts of interest and increased transparency. Furthermore, we support the Commission's position to preserve the discretion of ESG ratings providers in the methodologies to be used, and how to include and/or factor in various ESG factors.

Nevertheless, certain aspects of the proposed regulation raise significant concerns, particularly in terms of the **potential disproportionate impact on the competitive standing of emerging (smaller) players in the industry**. Despite the fact that the markets for ESG ratings and for ESG data are nascent market(s), a handful of major, global data providers (that also control the traditional financial data market) may entrench their dominance on ESG segments if the regulatory framework does not strike the right balance with respect to proportionality of regulation. These global data providers can notably leverage their resources and market share from non-ESG rating activities to compete against numerous small- and medium-sized players, many of whom have modest market shares. The regulatory framework in which they will operate tomorrow can be decisive in facilitating or undermining the competitiveness and viability of the business models of these small- and medium-sized players.

Our concern lies notably in the administrative rules and organisational requirements, which, if designed for the business model and back-office capabilities of large market incumbents, may unfairly benefit and protect those incumbents at the expense of emerging players thereby undermining competition, and diversity and choice of providers. Market incumbents can leverage their existing infrastructure, policies and economies of scale from other activities, resulting in a negligible impact on their commercial viability. In contrast, emerging players would be required to disproportionately allocate their limited resources to establish the same level of back-office capacity needed to comply with excessive administrative burdens. This diversion of resources would further hinder innovation and the ability of emerging players to compete effectively.

Therefore, it is imperative that the final regulation better reflects the principle of proportionality and supports the emergence of new competitors. Regulatory requirements should thus be commensurate with the business model and capabilities of the relevant data provider, safeguarding and promoting competition in the ESG data and ratings market(s). Failure to do so would disadvantage smaller competitors in an overly regulated environment, and would create barriers to entry for future competitors.

Regrettably, the current regulatory discourse seems to deviate from the initial draft legislation which incorporated the principle of proportionality, and appeared better designed to support the growth of emerging competitors in our industry. This shift raises considerable concerns among our members:

- **Criteria for Second Providers**: The Parliament introduced the concept of a «second provider», implying that if a client chooses to use two different ESG ratings providers, one of them should have a market share of not more than 15%. Such a concept is welcome. That said, on the one hand, exact knowledge of market shares may create uncertainty and implementation difficulties; on the other hand, too high a threshold would likely capture some of the larger market players, counter to the spirit of the Parliament's amendment. **Therefore, EASRA advocates for a clarification of this provision and a more competitive threshold of 5% to enable emerging competitors to disrupt the market. In addition, alternative criteria may be envisaged in case the market threshold raises too many implementation difficulties for the supervisor.**
- **Proportionality and Medium-sized players**: The Council's proposal to restrict the application of certain exemptions (for instance with regards to governance requirements under Article 20) to small undertakings or groups, thereby excluding medium-sized players from the scope of the proportionality principle embedded in

the draft text. However, the proportionality exemptions are just as crucial to enable medium-sized competitors to be able to compete against market incumbents without being disproportionately impeded by excessive administrative burdens. **EASRA supports keeping medium-sized undertakings in scope of the exemptions and lighter-touch requirements envisaged in the Regulation.**

- **Exclusion of ESG Data Providers**: The Regulation would apply only to providers of ESG ratings, scores and opinions; hence ESG data providers would fall outside the scope of the Regulation. EASRA believes in the strong interconnection between both types of players, with many firms in the market providing both ESG data and ESG ratings. Many proposed elements of the Regulation, including handling complaints and preventing conflicts of interest, are equally crucial for ESG data providers. Moreover, most ESG data providers use proprietary methodologies for estimations and/or modelled data when information is missing in corporate reporting. It is essential for the market to be informed and understand how these models work. **EASRA supports including all data providers that use estimations and models in the scope of the regulation, as proposed in the Parliament's position.**

We believe that maintaining a balanced regulatory framework is crucial for fostering a competitive landscape that accommodates both established and emerging players. This nuanced approach based on proportionality, which supports market competition, aligns with the legislative objective of enhancing the integrity and effectiveness of ESG ratings and data services. Consequently, such approach ultimately contributes to the overarching goal of establishing sustainable financial markets, as part of the European Green Deal.

FOOTNOTES

[1] The European Association of Sustainability Rating Agencies (EASRA), established in early 2023, aims to build a connection between and represent the interests of European financial service providers that produce ESG ratings, data, assessments, scores and opinions. At present, it counts the following firms among its members: Covalence, EthiFinance, GaiaLens, Impak Analytics, Inrate, Integrum ESG and Sesamm.