
AFME Technical Comments

Draft Statutory Instrument, The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No. 2) Order 2024

January 2025

The Association for Financial Markets in Europe (AFME)¹ welcomes the opportunity to provide technical comments on the draft legislation for the regulation of ESG ratings providers published by HM Treasury (HMT).

We have included below our technical comments on the draft legislation for your consideration and are happy to arrange a follow-up discussion with AFME members. Our comments aim to add clarity to the draft legislation, ensuring that the intended scope of the regulatory regime as set out in the consultation response is accurately reflected in the draft legislation.

Article 63V(1)(a) Regulated Products and Services Exclusion

We welcome HMT's policy intention to exclude regulated products and services from the requirement to apply for permission to provide ESG ratings, as reflected in Paragraph 3.39 of HMT's consultation response. Paragraph 3.39 makes explicit that this exemption is meant to apply broadly in respect of "any product or service that is regulated by the FCA" including investment research, which members understand to include all types of research, both independent and non-independent. We welcome the government's acknowledgment that investment research products are materially different to the ratings which the government aims to capture through the legislation. We also welcome and strongly support the statement in the consultation response that the "regulated products and services" exclusion ... applies to ... investment research. The mandate to the FCA to exclude all types of investment research should be clear and unambiguous.

Our members note the difference, however, between HMT's intended exclusion for "any product and service regulated by the FCA" and the draft legislation's reference to "regulated activity." Article 63V(1)(a) excludes persons who provide an ESG rating in the course of carrying on "another regulated activity" from the need to apply for dual authorisation from the FCA. Investment research itself is not a "regulated activity" as defined under the Regulated Activities Order (RAO); rather, investment research is a sub-category of "investment recommendations" which are subject to regulation under both COBS and MAR. Investment research is only a "regulated activity" within the RAO when such research is delivered as investment advice. Our members strongly support the exclusion of all investment research (independent and non-independent), including investment research not delivered as investment advice, from the requirement of applying for permission under the draft legislation. As discussed in detail in [our prior response](#), investment research of all types is subject to extensive regulation and adding an additional overlay of regulatory requirements would be unnecessarily burdensome and at worst contradictory. We have concerns about the drafting ambiguity in the draft SI, which, in our view, does not deliver the policy intent articulated in section 3.39. It would be helpful if HMT could share its analysis of how the exclusion as drafted operates to do this. For legal certainty and to allow the FCA to execute its mandate within a clear and unambiguous primary legislation framework, we have

¹ AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-European and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

included a suggested drafting amendment for discussion below directly in the text of Article 63V ***in bold and italicised text***. AFME members recognise the difficulty of drafting precise exclusions, so the below drafting is a starting point for discussion, but members consider clarity to address the exclusion of investment research to be critical and would appreciate a follow-up discussion with HMT on this matter.

63V.—(1) A person does not carry on an activity of the kind specified by article 63U by providing an ESG rating in the course of carrying on ***or providing*** —

- (a) another regulated activity,
- (b) ***an activity that would be a regulated activity, but falls within the scope of article 53(1A)), including any activity that falls within Part 3A of Schedule 2 of the RAO where this is provided by an authorised person,***
- (c) ***by an authorised person, i) investment research, as defined in Article 36(1) Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (“MiFID Org Regulation”) or, ii) an investment recommendation that does not meet the conditions set out in article 36(1) of the MiFID Org Regulation (“non-independent research”),***
- (d) an activity that is subject to approval by the FCA under a provision of assimilated law(a) or legislation restated by virtue of section 4 of the Financial Services and Markets Act 2023(b), or
- (e) an activity that is within the scope of a market access arrangement.

We welcome the clarification in Paragraph 3.37 of the HMT consultation response that the exemptions in the draft legislation are designed to capture the relevant activity, rather than the entity conducting the activity. This policy intention helps to clarify the scope of the exemption regarding ratings which are distributed/provided in the course of carrying on a regulated activity but produced within a large global group. Our members, who operate globally, understand that if a rating is produced by an overseas entity within a corporate group which is not authorised by the FCA, and such rating is then used by an FCA-authorised entity within that same corporate group to carry out the FCA-authorised entity’s regulated activity, such non-FCA authorised overseas group entity would not need to register with the FCA under this draft legislation. This is because the FCA’s existing set of regulations (e.g. COBS and MAR) would serve to protect the users who are receiving the products and services which are already regulated by the FCA, thus making dual registration superfluous. Overseas firms who produce ESG ratings as part of the development and delivery of a UK regulated product or service should not be unnecessarily required to register with the FCA when the product or service they are delivering is already regulated by the FCA.

Article 63V(2) Standalone Product or Service

Article 63V(2) of the draft legislation carves out ESG ratings provided as a standalone product or service from the exclusions set out in Article 63V(1)(a) – (c). The language “standalone product or service” is not defined in the draft legislation, so AFME reads this naturally to mean that ESG ratings which are incorporated into a product or service where these products or services are already regulated by the FCA are excluded.

We believe this interpretation is consistent with the government’s intention as set out in the consultation response. For the same reasons expressed above, we would suggest either to delete Article 63V(2) or include the below suggested drafting amendment ***in bold and italicised text*** to provide this clarity.

(2) For the purposes of paragraph (1), an ESG rating is not provided in the course of carrying on an activity under (a), ***(b) or (c) or (d)*** where it is provided as a standalone product or service ***and such standalone product or service is not itself subject to FCA regulatory requirements.***

Article 63W Intra-group Ratings

Article 63W of the draft legislation excludes ratings provided between members of a consolidated group, where the ESG rating provider “reasonably expects that the ESG rating will not be made available” to third parties. We welcome the clarification in Paragraph 3.51 of the HMT consultation response that the exemption is designed to cover both “internal ratings” produced for a financial services firm’s own use and “intra-group” ratings. To the extent possible, members request explicit clarification in the draft SI that the “intra-group” exclusion also excludes internal ratings which financial services firms develop for their own use, even if not distributed to other group members. To achieve this, we suggest amending the defined term “made available” in Article 63ZB ***in bold and italicised text*** as follows:

“made available” ***means providing to another person, including but not limited to,*** in hard-copy or electronic form or publishing on a website or other digital medium;

Article 63U(2) Jurisdictional Scope

As other jurisdictions adopt regulatory regimes based upon the IOSCO recommendations, particularly the EU, it is important to maximise the international interoperability of the UK regulatory framework with other jurisdictions. HMT should instead consider the introduction of substitutive compliance/equivalence provisions based on third country providers complying with the IOSCO recommendations subject to a positive assessment provided by their local regulatory competent authority.

The draft legislation brings into the regulatory perimeter providers of ESG ratings who are located in the UK or who make ESG ratings available to a person located in the UK by way of a business relationship. Members note that this territorial scope is broader than the UK regulatory perimeter which is set out in Section 19 of FSMA.

While the draft legislation includes a placeholder for specific market access arrangements, HMT should carefully consider which market access arrangements would allow overseas firms to provide ESG ratings to persons located in the UK without the requirement to obtain authorisation in the UK. We agree with the list of arrangements set out by HMT in the response. The lack of clarity regarding market access and the ability of UK regulated firms to use ESG ratings produced by ESG ratings providers in third countries parallels concerns which members have raised regarding the use of benchmarks produced by third-country benchmark administrators.

Article 63U(3)(a) – (c) ESG Ratings

Members note that there is no indication in this Article whether clauses (a) – (c) are intended to be cumulative or mutually exclusive; it’s not clear whether all three or only one of these clauses must apply. We assume that clauses (a) – (c) are intended to be cumulative and suggest adding the word “and” at the end of clause 63U(3)(a)(c) for clarity.

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