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## EU ESG Ratings Regulation

### AFME's reflections for the trilogues

January 2024

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AFME welcomes the progress in the negotiations on the ESG Ratings Regulation (the “**Regulation**”) and wishes to highlight priorities for the co-legislators to take into account in the context of the trilogue negotiations and finalisation of the Regulation.<sup>1</sup>

AFME's overarching priority is to ensure that the Regulation is effective in regulating the rating providers it is designed to regulate, rather than conflicting with existing regulatory requirements or introducing new requirements for users or rated entities. We support the efforts to increase the transparency and integrity of ESG ratings.

In the context of the trilogues, we consider that the following elements are essential as the co-legislators agree the final legislation:

#### Scope: activities of regulated financial undertakings

We welcome the recognition in both the Council and European Parliament texts of the need to clarify exemptions to ensure that the Regulation does not introduce duplicative regulation for products and services of financial institutions that are already regulated. We have set out in the Annex to this note our proposed compromise drafting which leverages both the Council and Parliament texts.

We strongly support the exemption provided by the Council for ESG ratings produced by regulated financial undertakings that are incorporated to products or services that are already regulated under EU law or derived from a regulatory obligation.<sup>2</sup> It is essential to include such an exemption to avoid duplicative and conflicting regulation and to avoid damaging the provision of services such as investment research in the EU and other regulated services, for example as part of the provision of credit.

We strongly support the recognition by both the Council and Parliament of the need to clarify that the Regulation is not intended to apply to content produced by financial analysts within the investment research division of a regulated financial institution.<sup>3</sup> It is essential that this is clearly excluded to avoid damaging consequences for EU investors, for EU capital markets and for financing the transition.

We also strongly support the exclusion of ESG ratings used by financial undertakings for internal purposes within a group and welcome that this is clarified in both the Council and Parliament texts. Finally, we continue to support the exemption provided for ESG ratings from an authorised ESG rating provider which are made available to users by third parties<sup>4</sup>. In line with this exemption, we would suggest clarifying the Council's definition of 'ESG rating provider' in Article 3 to 'a legal person whose occupation includes the issuance, publication **and** distribution of ESG ratings on a professional basis', to avoid unintentionally capturing third parties which lawfully distribute, but do not issue, ESG ratings.

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<sup>1</sup> AFME's position paper on the Commission proposal is available [here](#)

<sup>2</sup> Article 2(2)(b)(ii) of the Council General Approach

<sup>3</sup> Article 2(2)(e) of the Parliament Report and Recital 15 of the Council General Approach

<sup>4</sup> Article 2(2)(h)

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### Scope: non-profit entities

- We believe that the Regulation should not distinguish between for-profit and not-for-profit providers of ESG Ratings. Several non-profit providers produce ESG ratings which can have a significant influence on the market and therefore should be subject to the same standards as other providers. Such an exemption could create an uneven playing field in the market.

### Scope: raw ESG data products

- We note that both the Council and Parliament introduce a review clause for the European Commission to consider the potential regulation of ESG data providers. AFME is supportive of this approach.

### Effective interactions between ESG rating providers and rated entities

- As recognised in the IOSCO Report and Recommendations<sup>5</sup>, it is important to ensure efficient and effective interactions between ESG rating providers and rated entities. AFME supports the Council's additional Article 14(11a) which will both enhance the quality and transparency of ESG ratings and allow rated entities greater access to the complaint-handling mechanism. This text is more comprehensive than the Parliament's amendments to Article 22(1b) and (1c), which do not provide for the same fact-checking process.
- We support the Council's addition to Article 25(2) which gives ESMA the authority to request evidence regarding ESG rating providers' pricing policy, fee structure and pricing criteria.

### General principles and transparency

- AFME does not support the Parliament's new Article 16a which mandates rated entities and investors seeking multiple ratings to consider appointing a smaller ESG rating provider to issue a rating. This would reduce choice for users and may restrict their ability to select the most appropriate product for their needs. The mandate could also result in rated entities having to consider new providers if a provider passes a 15% market share threshold, which could impact consistency of disclosures across time periods.
- We do not support the Parliament's new requirement in Article 22(1a) for users of ESG ratings which disclose or distribute ESG ratings to disclose the information referred to in part II of Annex III to the persons receiving the ESG ratings. This requirement extends beyond the purpose of the Regulation by introducing obligations on users of ESG ratings and rated entities. If included, any such obligations should be limited to passing on a link to the website of the ESG rating provider but only where that information is available and is provided to the user.
- Finally, AFME supports the Parliament's additions to part II of Annex III which require additional disclosures regarding the data sources used to develop ESG ratings including, among other items, the time horizon covered for analysis and timing of data used for evaluation.

### Independence and conflicts of interest

- We support the amendments which the co-legislators have made to Article 15 to allow for ESG rating providers to provide other activities provided that conflicts of interest are effectively managed. While it is important that effective processes are in place to identify and manage any such potential conflicts

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<sup>5</sup> See IOSCO Recommendations 8 and 9

of interest, mandatory separation may not be necessary and could increase costs for users of ESG ratings products. We suggest that a definition is included of “consulting services” as this could be interpreted very broadly (e.g. as including regulated financial undertakings’ M&A advisory activities) and should be focused on consulting services relating to ESG.

### Third country regime

- AFME continues to highlight the importance of a third country regime that is workable in practice. With respect to endorsement, AFME supports the Council text of Article 10(1)(b), which clarifies that an ESG rating provider can seek a global endorsement of the ratings it provides rather than individual endorsement of each ESG rating, making this more practicable.
- AFME also supports the Parliament’s removal of the size threshold for ESG rating providers that can apply for recognition. Allowing ESG rating providers the flexibility to seek recognition regardless of size would encourage competition among ESG rating providers and avoid unnecessary fragmentation.

We hope that these points are addressed as the co-legislators finalise the regulation and are happy to provide further feedback from the perspective of AFME’s bank and asset manager members.

### About AFME

The Association for Financial Markets in Europe (AFME)<sup>6</sup> represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU 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.

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<sup>6</sup> AFME is registered on the EU Transparency Register, registration number 65110063986-76.

## Annex: proposed compromise re scope for regulated financial undertakings

We strongly support a combination of Article 2(2)(b), as amended by the Council, and Article 2(2)(e), as amended by the Parliament. This would provide the necessary clarity on the treatment of products and services provided by regulated financial undertakings, supported by the Council's proposed amendments to Recital 15 and its introduction of Recital 15a. We set these out below for ease of reference, proposing only two minor clarifications to the wording shown in bold italics.

### Article 2(2)(b) [Text origin: Council mandate]

2. This Regulation does not apply to any of the following:

(b) ESG ratings produced by regulated financial undertakings in the Union that are:

- (i) used for internal purposes, or provided to other entities that are part of the same consolidated group or;
- (ii) incorporated ***in*** products or services which are provided by credit institutions, investment firms, fund managers, insurers, benchmark administrators or financial institutions, or required by or derived from a regulatory obligation applicable to such services or products, where such products or services are already regulated under Union law, including under, but not limited to Regulation (EU) 2019/2088, Directive 2013/36/EU, Directive 2014/65/EU, Directive 2009/65/EC, Directive 2011/61/EC, Regulation 2014/596/EU and Regulation 2016/1011/EU;

### Article 2(2)(e) [Text origin: EP mandate]

(e) products or services that incorporate an element of an ESG rating ***and*** content produced by financial analysts within the investment research division of a regulated financial undertaking;

### Recitals 15 and 15a [Text origin: Council mandate]

(15) Rules on ESG rating providers should not apply to private ESG ratings produced pursuant to an individual order and provided exclusively to the person who placed the order and which are not intended for public disclosure or distribution by subscription or other means. Neither should such rules apply to ESG ratings produced by European financial undertakings that are used for internal purposes or incorporated ***in*** products or services which are provided by credit institutions, investment firms, fund managers, insurers, benchmark administrators or financial institutions, or required by or derived from a regulatory obligation applicable to such services or products, where such products or services are already regulated under Union law. [...] Moreover, such rules should not be applicable to products or services that use an ESG rating as a benchmark or as an evaluation or screening tool, including for instance ESG ratings used for the purposes of research or for an academic, journalistic or consumer paper and the content produced by financial analysts within the investment research division of a regulated financial undertaking [...].

(15a) Where an undertaking or financial institution discloses information about its own sustainability impacts, risks and opportunities or those of its value chain, such information should not be considered as an ESG rating under this Regulation.