International
Capital
Market
Association

ICMA

14 January 2025

Comments on the draft regulation for Environmental, Social, and Governance (ESG) ratings providers

The International Capital Market Association (ICMA) welcomes the opportunity to provide comments on the HMT's draft regulation 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 610 members located in 70 jurisdictions. See www.icmagroup.org.

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

The comments below have been directly submitted to ESGRatingsConsultation@HMTreasury.gov.uk

Sincerely,

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ICMA read with interest HMT's summary of responses from its 2023 consultation (CP) on a future regulatory regime for Environmental, Social, and Governance (ESG) ratings providers. ICMA's response to that CP can be found here. We agree that ESG factors increasingly matter in financial markets as, among other things, they serve as guidance for investors including asset managers and asset owners on their capital allocations.

ICMA maintains the voluntary Code of Conduct for ESG Ratings and Data Product Providers which has also been implemented in Hong Kong. Furthermore, ICMA hosts the Singapore Code of Conduct.

Process:
We very much welcome the government's intention to create a regulatory regime that is consistent with international and other jurisdictional standards to avoid the risk of fragmentation. As IOSCO's 2021 recommendations have already been implemented via various global voluntary codes of conduct, and market participants have become familiar with these, we consider it vital that a future regime will take account of these IOSCO recommendations. Hence, we appreciate the FCA already having stated that its regime will be "*proportionate and in line with the IOSCO recommendations, which focus on transparency, good governance, managing conflicts of interest, and proper systems and controls*".

Further to the above, we would especially like to emphasise that there should be limited divergence with the existing EU regulation which came into force on 2 January 2025, in order to avoid fragmentation. We note that the EU has gone further than IOSCO's recommendations in terms of governance requirements, separation of entities and other more stringent and complex requirements. We therefore believe it would alleviate the burden on ESG rating providers but also be in the interest of other market participants such as asset managers, if, using IOSCO recommendations as a baseline, compliance with the EU regulation could be considered as complying with the UK requirements. Ideally, this would then also be adopted by other global jurisdictions planning to introduce regulation.

Definitions:
We are pleased to see that the definitions for what constitutes an "ESG rating" an "ESG Opinion" and an "ESG score" are similar between the draft SI and the EU regulation. However, what exactly constitutes an "assessment" is often difficult to determine, and as a result the scope of what is meant by an ESG rating could include many ESG data products that have, for example, an output in form of a ranking system.

While we are generally happy with the draft SI, members have some concerns regarding the government's intention to expand the regulatory regime to capture ESG ratings which are *"likely to influence a decision to make a specified investment"*. We consider this to be very difficult to determine as, for example, ESG ratings providers will not know what is likely to influence an investor's investment decision or simply form part of due diligence. It could also be argued that every piece of information can influence an investment decision.
In addition, the government should reconsider its approach to the above when looking at analytics that could have an influence on investment decisions such as temperature. From asset managers' experience, temperature could be viewed as a risk measure rather than a guide to investment decisions and therefore would not be a good output to consider.

Exclusions:
We welcome the fact that internal ratings will be excluded from a future regulatory regime and would appreciate this also applying to intra-group ratings. Referencing the above made point regarding the avoidance of fragmentation, we would like to highlight that the EU regulation is clear on intra-group (intragroup) ratings not being in scope and would like to see the UK equally exclude intra-group ratings: ESGR Art. 2.2: *"This Regulation does not apply to… ESG ratings issued by regulated financial undertakings in the Union that are used exclusively for internal purposes or for providing in-house or intragroup financial services or products".*

Data products:
Finally, when it comes to data, we receive different views from asset managers. Some would like to see a future regulation being extended to include ESG data providers, others do not support the inclusion of data providers. In our response to HMT in 2023, we had advocated for including ESG data providers which would be consistent with IOSCO's recommendations. However, some asset managers fear this could lead to increased costs being passed on to the investor, potentially stifling innovation, and competition in the market. Representing the views of these asset managers, we can also see that transparency, could be addressed through a voluntary code of conduct like the one developed by the ESG Data and Ratings Working Group (DRWG), now hosted and maintained by ICMA.

In any case, as already mentioned above, without a definition of what is meant by "assessment", this could result in some ESG data products being included after all. For further clarification, 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.