# PensionsEurope input to the EC consultation on ESG ratings and ESG factors in credit ratings

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## 1. PensionsEurope input to the European Commission consultation on the functioning of the ESG ratings market in the EU and on the consideration of ESG factors in credit ratings

*General remarks*

**As the European umbrella organisation representing pensions in Europe, we welcome the European Commission consultation on ESG ratings and ESG factors in credit ratings. In general, we share many of the Commission's concerns about their shortcomings, and we also welcome the Commission's further work to improve the ratings and the functioning of the market. In our input, we propose to adopt a holistic and coordinated regulatory approach to both financial and non-financial (ESG) data in the EU, as well as establishing a proper regulatory framework for data providers.**

This consultation concerns ESG ratings. The current main challenges for pension funds are related to ESG data. There is clearly a **lack of reliable and accurate ESG data, which pension funds need to report under the SFDR**. The growth of the ESG market has led to an increase in data, but that has also added to confusion in the market. PensionsEurope encourages the European Commission to closely monitor the ESG data offer and its comparability between providers.

However, there are also issues relating to ESG ratings. There are concerns around **transparency which leads to a lack of understanding what the ratings represent**. ESG ratings vary a lot by ratings provider, as they use their own unique methodologies for assigning company-specific ratings, and only few companies disclose the underlying indicators or their actual weights of their assessment.

There are also **various potential conflicts of interest across the business models and product offerings of sustainability-related product and service providers**. For instance, when providers both assess companies and offer paid advisory services or charge companies to see their own reports. Finally, the European pension funds have also been concerned that the **available data is more and more provided by few specialized agencies headquartered in the US**.

In general, the **ESG rating market has rather oligopolistic characteristics and another concern is that these agencies might have views, analyses, and opinions on ESG matters different from those in Europe, particularly on climate change issues**. This information can be **biased** in the EU context, as there is a recognition that availability of data is jurisdiction dependent.

**We agree with the Commission that there are various challenges and shortcomings in relation to the consideration of sustainability risks in credit ratings and the disclosures made by credit rating agencies.** In general, ESG factors are much broader than only financial aspects which impact the creditworthiness of companies; moral and principal aspects also play an important role, but these should not be part of a credit rating. Alternatively, credit rating agencies could only include ESG-aspects in their processes/ratings in so far as they influence the creditworthiness of the company. This should then be made explicit and transparent.

In our input below, **we have particularly focused on the questions which we have found the most relevant to us** (and on top of our answers, we have also included the page numbers and the questions).

*Answers to specific questions*

**PART A – ESG RATINGS**

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1. **Questions for investors, asset managers and benchmark administrators**

**Do you use ESG ratings?**

**Yes, very much**

*Yes, a little*

*No*

**Which type of ESG ratings do you use (non-exhaustive list – multiple answers possible):**

**ESG ratings providing an opinion on companies:**

- **ESG ratings providing an opinion on opportunities**
- **ESG ratings providing an opinion on the compliance of companies with frameworks and rules**
- **Exposure to and management of ESG risks**
- **ESG ratings providing an opinion on a company performance towards certain objectives**
- **ESG ratings providing an opinion on the impact of companies on the society and environment**
- **ESG ratings providing an opinion on the ESG profile of the company**

**ESG ratings providing an opinion on investment funds:**

- **exposure to and management of ESG risks**
- **impact on the society and environment**
- **ESG characteristics**
- **Other specialised ratings**
- *None*
- *Not applicable*

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**To what degree do you use ESG ratings in investment or other financing decisions on a scale of from 1 to 10 (1- very little, 10 – decisive)?**

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**Do you use overall ESG ratings or ratings of individual Environmental, Social or Governance factors?**

- **Overall ESG ratings**
- **Ratings of an individual Environmental, Social and Governance factors**
- **Ratings of specific elements within the Environmental, Social and Governance factors,**

- *other types, please specify*

**Do you buy ESG ratings as a part of a larger package of services?**

- **Yes**
- *No*
- *Not applicable*

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**If you responded yes to the previous question, do you consider that buying ESG ratings as a part of a larger package would give rise to potential conflicts of interests?**

**Yes**

**What are you using ESG ratings for? (multiple choice)**

- **as a starting point for internal analysis**
- **as one of many sources of information that influence the investment decisions**
- **to meet regulatory or reporting requirements**
- **as a decisive input into an investment decision**
- **as a reference in financial contracts and collaterals**
- **for risk management purposes**
- *other(s).*

**What do you value and need most in ESG ratings:**

- **transparency in data sourcing and methodologies,**
- **timeliness, accuracy, and reliability of ESG ratings**
- **final score of individual factors**
- **aggregated score of all factors**
- **rating report explaining the final score or aggregated score**
- *specific information, please explain*
- **data accompanying rating**
- *other aspects*

**Explain:**

**Selected individual Key Performance indicators (KPIs) are highly relevant for pension funds' investment processes. However, there is room for improvement regarding the providers' selection of KPIs (in particular adding more performance based KPIs).**

**Aggregated ESG ratings are not very relevant for pension funds' investment process. The methodological choices made by the providers (including how qualitative information is transferred into quantitative measures as well as often large number of KPIs and not always relevant KPIs) combined with sometimes inadequate transparency into the ratings has made the ratings less useful.**

**Having said that, pension funds find it useful to be aware of the rating results and sometimes use them as input for another view.**

**To what degree to you consider the ESG ratings market to be competitive and allows for choice of ESG rating providers at reasonable costs, on a scale from 1 (not competitive) to 10 (very competitive)?**

**2**

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3. **Questions for all respondents**

**Do you consider that the market of ESG ratings will continue to grow?**

- **Yes**
- *No*
- *No opinion*

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**If you responded 'yes' to the previous question, to what extent do you expect the following factors to be decisive, on a scale from 1 (not at all) to 10 (very much)?**

- Growth in demand from investors in ratings of companies for their investment decisions **9**
- Growth in demand from companies in ratings including on rating future strategies
- Further standardisation of information disclosed by companies and other market participants **9**
- *Other*

**Are you considering using more ESG ratings in the future?**

- *Yes, to a large degree*
- **Yes, to some degree**
- *No*
- *No opinion*

**Do you mostly use ESG ratings from bigger or larger market players?**

- *Exclusively from large market players*
- **Mostly from larger market players**
- *Mixed*
- *Mostly from smaller market players*
- *Exclusively from smaller market players*
- *Not applicable*

**Do you consider there is a sufficient offer of ESG ratings from providers located in the European Union?**

- *Yes*
- **No**
- *No opinion*

**If you responded 'no' to the previous question, please explain why**

**A significant portion of critical market data providers are headquartered outside of the EU. The absence of EU authorisation or localisation requirements for data providers providing financial and non-financial data to European users is a concern.**

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**Finally, do you use other types of ESG assessment tools than ESG ratings (e.g. controversy screening, rankings, qualitative assessments, etc.)?**

- **Yes**
- *No*

**Do you believe that due diligences carried out by users of ESG research are sufficient to ensure an acceptable level of quality?**

- *Yes*
- **No**
- *Don't know / no opinion / not applicable*

**Do you further believe that ESG research products have reached a sufficient level of maturity and comparability to allow users to fully understand the products they use?**

**No, ESG research products are not sufficient comparable. The comparability of the different ESG data is rather poor due to different methodological choices made by the providers. The demand for ESG data has increased over the years and companies have improved on their disclosures. Large public companies for instance publish considerable amounts of ESG data. The improved disclosures have also had a positive impact on the quality and reliability of ESG data supplied by the ESG research/rating providers, but their data quality is at times falling short of expectations. For example, sometimes companies in some of the emerging markets disclose more information in local language or are subject to stringent local regulations, which the data provider might have missed. Also, the data from the providers can be outdated and the selected KPIs do not always provide (in our view) a relevant proxy for the ESG risk.**

**As a result, the correlation between data sets from different providers on ESG information such as CO2 intensity can be low. This is a huge problem because pension funds rely on data providers for SFDR reporting. The aim of the SFDR is that e.g. PAI disclosures can be compared between products, but if the underlying data is not comparable, the SFDR disclosures are not comparable either.**

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**II. Functioning of the ESG ratings market**

**How do you consider that the market of ESG ratings is functioning today?**

- *Well*
- **Not well**

**Please explain**

**Most EU financial markets participants have to use the products and services of a handful of oligopolistic data providers to comply with EU regulations. These companies have the critical size to aggregate and sell data in a raw and/or processed format via bundled services and mandatory use of proprietary operating systems, submitted to multi-layered licensing requirements. Financial markets participants, which are data users, rely on these actors to provide e.g. data from exchanges (for an efficient allocation of investments), financial indexes (essential in the design of financial products), or non-financial information from EU companies (to identify and invest in sustainable activities).**

**Data providers have limited accountability provisions regarding the transparency, efficiency and reliability of their services, as there are currently very few regulatory requirements applying to these services within the EU. As a result, data providers' services are frequently opaque. For example, there is insufficient scrutiny regarding their analysis methodologies, as each data provider applies its own.**

**Moreover, switching from one ESG data provider to another is usually costly if this data is used in benchmark construction. First, because this would imply turnover (transaction costs) in the portfolio. Second, because there are limits to which ESG data can be used by the different benchmark providers, which implies that you might have to change your benchmark provider if you want to switch to another supplier of ESG ratings. For example, if you use MSCI as a benchmark provider, MSCI will not use ESG data from for example Sustainalytics in their benchmark construction. One would need to switch to another benchmark provider to use the Sustainalytics data in the benchmark construction. These high switching costs make the market less competitive.**

**To what degree do you consider that the following shortcomings / problems exist in the ESG ratings market, on a scale of from 1 to 10 (1- very little, 10 – important)?**

- Lack of transparency on the operations of the providers **10**
- Lack of transparency on the methodologies used by the providers 7
- Lack of clear explanation of what individual ESG ratings measure 8
- Lack of common definition of ESG ratings **7**
- Variety of terminologies used for the same products **7**
- Lack of comparability between the products offered **7**
- Lack of reliability of the ratings 6
- Potential conflicts of interests **10**
- Lack of supervision and enforcement over the functioning of this market **9**
- Other

**What do you think of the quality of the ratings offered on a scale from 1 (very poor) to 10 (very good)?**

**5**

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**If you responded 'very poor' or 'poor' to the previous question, to what degree do you consider that this affect your trust in the products that are offered, on a scale from 1 (no affect) to 10 (affects very much)?**

**7**

**Do you consider that there are any significant biases with the methodology used by the providers?**

- **Yes**
- *No*
- *No opinion*

**If you responded yes to the previous question, please specify the biases**

- *Biases based on the size of the company rated*
- **Biases based on the location of the company**
- *Other biases: Biases based on the size of the company rated and biases based on the location of the provider*

**Do you think the current level of correlation between ratings assessing the same sustainability aspects is adequate?**

- *Yes*
- **No**

- *No opinion*

**To what degree do you consider that a low level of correlation between various types of ESG ratings can cause problems for your business and investment decision, as an investor or a rated company, on a scale from 1 (no problem) to 10 (significant problem)?**

**6**

**In general, low levels of correlations between various types of ESG ratings can cause reliability concerns, but they are not causing huge problems for investment decisions, if they can be explained with the use of different methodologies.**

**However, it is important that the used methodologies are well disclosed, and it is needed to have common ground and standards at the company data level to ensure that the ratings reflect the analysis of reliable data related to materiality and correct assessment of ESG factors.**

**A large dispersion between ESG rating providers can decrease the readability of ESG ratings.**

**How much do you consider each of the following to be an issue, on a scale from 1 (no issue) to 10 (very significant issue)**

- There is a lack of transparency on the methodology and objectives of the respective ratings **10**
- The providers do not communicate and disclose the relevant underlying information **10**
- The providers use very different methodologies **7**
- ESG ratings have different objectives (they assess different sustainability aspects) **7**
- **Other issue(s): ESG data in the EU depends on an oligopoly of mainly non-EU data providers. When a client imposes a provider which requires a change of the existing provider for a given fund, it is difficult to keep a history as methodologies change across providers.**

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***To what degree do you consider this market to be prone to potential conflicts of interests on a scale from 1 (very little) to 10 (very much)?***

**10**

***If you responded 'yes' to the previous question, where do you see the main risks? (multiple choice)***

- ***Where providers both assess companies and offer paid advisory services***
- *Where providers charge companies to see their own reports*
- ***In the absence of separation of sales and analytical teams***
- ***With the ownership system of some providers, where the parent company may exert undue pressure or influence on the research and recommendations that a ratings provider offers***

- **In the lack of public disclosure of the management of potential conflicts of interest**
- *Other conflict(s) of interest*

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***To what degree do you consider the fees charged for ESG ratings to be proportionate to the services provided, on a scale from 1 (not proportionate) to 10 (very proportionate)?***

**1**

***Do you consider that information on the fees charged by the providers is sufficiently transparent and clear?***

- *Yes*
- **No**
- *No opinion*

***If you responded 'no' to the previous question, please specify what you consider should be the minimum information to be disclosed***

**The EU should ensure the fairness of pricing practices regarding data providers' services, as the prices have been skyrocketing over the past years (besides that there has been a general pressure on prices for financial products). Beyond transparency for methodologies by data providers when providing services more complex than dissemination of raw data from issuers (e.g. analysis, scorings, ratings etc.), transparency regarding data fees would contribute to a more balanced effort on financial products' prices, which would lead to a fairness in costs ultimately beneficial to end investors – and especially for retail investors.**

**One of the objectives would be to simplify, standardise and make more transparent the user fees and pricing conditions imposed by data providers. In particular, it could draw on the FRANDT (fair, reasonable, non-discriminatory and transparent) principle already existing in the EMIR Regulation and which should be extended to other regulations.**

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**III. EU intervention**

**a) Need for an EU intervention**

**Taking into account your responses to the previous sections, do you consider that there is a need for an intervention at EU level to remedy the issues identified on the ESG rating market?**

- **Yes**
- *No*
- *No opinion*

**Please explain why:**

**Various interventions at EU level, for instance through industrial initiatives promoting European players and standards, would be welcome and needed.**

**Some EU data providers are starting to emerge, but they cannot reach the sufficient size to survive in this market due to its oligopolistic nature and the fact that many up-and-coming actors are immediately bought up by existing data providers. Therefore, it is worth considering alternatives to the predominance of current index and data providers. For example, regarding indices, the creation of an index category by the financial markets' participants themselves, recognised by the regulators, would be something to consider.**

**In the same way, the EU's voice must be heard in the setting of international standards regarding non-financial data, which would contribute to the adequation between providers' services, and financial markets participants' needs in terms of regulatory compliance.**

**Furthermore, regarding third country data providers, other regulatory evolutions such as the establishment of an equivalence regime, particularly regarding the quality and reliability of the data provided, would make sense. This also involves the establishment of a genuine consolidated European tape (Commission Action No. 14 on the CMU Commission Action Plan) and autonomous market data repositories which, with the use of new technologies, would enable secure sharing and reasonable costs of high-quality data for the benefit of the industry as a whole.**

**We believe that addressing the competition aspects of the current oligopolistic situation of data providers is also important in guaranteeing EU actors have access to reliable financial and non-financial data. Data providers should be subject to a duty of transparency and publication of their prices, to reduce the opacity of their pricing policy.**

**If you responded yes to the previous question, what type of intervention would you consider necessary?**

- *Non-regulatory intervention (e.g. guidelines, code of conduct)*
- **Legislative intervention**

**If you responded yes to the previous question, what do you consider should be the prime focus of the intervention? (multiple choice)**

- **Improving transparency on the operations of the providers,**
- **Improving transparency on the methodology used by the providers,**
- **Improving the reliability and comparability of ratings,**

- **Clarifying what is meant by and captured by ESG ratings, to differentiate from other tools and services,**
- **Clarifying objectives of different types of ESG ratings,**
- **Improving transparency on the fees charged by the providers,**
- **Avoiding potential conflicts of interests,**
- **Providing some supervision on the operations of these providers,**
- *Other measures (please specify).*

**For each of the points you selected in the previous question, please explain what solutions and options you would consider appropriate**

**We propose to adopt a holistic and coordinated regulatory approach to both financial and non-financial (ESG) data in the EU, as well as establishing a proper regulatory framework for data providers. A holistic regulatory approach to data providers should be threefold.**

1. **Ensuring coherence between the few pieces of EU legislation mentioning data provision services**

**Currently, EU legislations adopts a silo approach regarding data providers' services on financial data: MiFID II, CRA Regulation, the Benchmark Regulation all mention these activities, without providing much of a coherent framework. Several important provisions already exist regarding transparency of activities, conflict of interests. However, these provisions are fragmented and limited to certain categories of data providers. Implementing a "cross-functional" regulation would provide such a framework for all these actors.**

2. **Facilitate direct access to data to lighten dependency on data providers**

**We support the Commission's initiatives to make non-financial data more directly available to market participants (CSRD), as well as the single access point for EU financial and non-financial data (ESAP). Access to reliable, comparable, and audited non-financial data, is essential to answer clients' growing demand for transparent and sustainable financial products. It enables investors to efficiently direct investments towards truly sustainable activities, and ultimately incentivize a larger scale transition towards a sustainable economy. In the same way, an EU consolidated tape as part of the MiFID II/MiFIR review, would contribute to lessen the need to use data providers services. Achieving a consolidated tape would make all European market data easily accessible both for professional and retail investors and increase trust for cross-border investments.**

**Additionally, such policies would be beneficial for competition within the EU, as data providers will have to clearly demonstrate the added value of their analysis and commercial proposals compared to in-house analysis. This will increase the overall quality and transparency of these markets.**

3. **Implement new transparency and accountability requirements for data providers' activities**

**ESG ratings activities are especially important in this regard, as they form the basis to identify how sustainable the activities of companies are. However, according to the recent study the Commission requested on sustainability ratings, it appears that these methodologies vary between data providers, bringing widely different results even when analysing the same companies. In addition, data providers do not take any responsibility for these gaps.**

**Data providers' methodologies should be sound enough to avoid any risk of greenwashing that could lead to negative consequences on the whole investment chain. We would encourage a regulatory approach to create a transparency framework for these activities, as was proposed recently by ESMA in its letter to the European Commission, or by the joint proposal by the French and Dutch supervisors (AMF/AFM) on the same subject. On this specific point, we note that the European Commission will propose a consultation on ESG ratings markets at the end of 2021 as part of its Sustainable strategy to finance climate transition. We welcome this initiative but consider this step forward is not ambitious enough given the wide acknowledgement of this issue across financial markets' participants.**

**The EU should implement a horizontal European regulation for both financial and non-financial data providers and their activities, which should be accompanied by increased supervision of all data providers at the European level according to ESMA's 2020-2022 strategic guidelines, in which the European authority says it wants to strengthen its reputation as the supervisory authority of credit rating agencies, critical benchmarks and data service providers.**

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**Do you consider that the providers should be subject to an authorisation or registration system in order to offer their services in the EU?**

- **Yes**
- *No*
- *No opinion*

**Do you consider that the providers should be subject to an authorisation or registration system in order to provide ESG ratings on EU companies or non-EU companies' financial instruments listed in the EU even if they offer services to global or non-EU investors?**

- **Yes**
- *No*
- *No opinion*

**Do you consider that there should be some minimum disclosure requirements in relation to methodologies used by ESG rating providers?**

- **Yes**
- *No*
- *No opinion*

**Please explain why:**

**Minimum disclosure on the methodology used will allow investors to understand the ESG rating provided and improve comparability between ESG rating providers. Such minimum disclosure should not be prescriptive in terms of methodology but should be focused on transparency and good practices of the industry.**

**Do you consider that the providers should be using standardised templates for disclosing information on their methodology?**

- **Yes**
- *No*
- *No opinion*

**Do you consider that the rules should be tailored to the size of the provider and hence have smaller providers subject to a lighter regime?**

- **Yes**
- *No*
- *No opinion*

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**If you responded yes to the previous question, please specify what metric you consider should be used to differentiate between providers:**

- **Total revenue**
- **Revenue from ESG ratings**
- **Number of employees**
- *Other metric(s)*
- **in the case of providers located outside the EU and not providing services to EU investors but rating EU companies/financial instruments – percentage of EU companies/financial products rated**

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**PART B – INCORPORATION OF ESG FACTORS IN CREDIT RATINGS**

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**I. Questions to users of credit ratings**

**Do you use credit ratings for investment decisions?**

- *Yes, as a starting point for internal analysis*
- **Yes, as one of many sources of information that influence investment decisions**

- *Yes, as a decisive input into an investment decision*
- *No*
- *Other*

**Is it important for you to understand to what extent individual credit rating actions have been influenced by sustainability factors?**

- *Not important at all*
- *Slightly important*
- **Important**
- *Very important*
- *No opinion*

**Do you find information about the extent to which CRAs methodologies or the rating process incorporate sustainability factors sufficiently well disclosed?**

- *Yes*
- **No**
- *No opinion*

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**Where do you look currently for the information on how ESG factors impact the credit rating? (multiple choice)**

- **Press release accompanying credit ratings**
- **Additional analysis and reports available to subscribers**
- **Additional information materials available publicly**
- **Description of methodologies or rating process for specific asset classes, sectors or types of entities**
- **Frameworks or documents describing general approach to incorporation of ESG factors in credit rating process**
- *I don't know where to find such information*
- Other

**Does the level of disclosure differ depending on individual CRAs?**

- **Yes**
- *No*
- *No opinion*

## About PensionsEurope

**PensionsEurope** represents national associations of pension funds and similar institutions for workplace and other funded pensions. Some members operate purely individual pension schemes. PensionsEurope has **25 member associations** in 18 EU Member States and 4 other European countries[1].

PensionsEurope member organisations cover different types of workplace pensions for over **110 million people.** Through its Member Associations PensionsEurope represents **€ 7 trillion of assets** managed for future pension payments. In addition, many members of PensionsEurope also cover personal pensions, which are connected with an employment relation.

PensionsEurope also has **19 Corporate and Supporter Members** which are various service providers and stakeholders that work with IORPs.

PensionsEurope has established a **Central & Eastern European Countries Forum (CEEC Forum)** to discuss issues common to pension systems in that region.

PensionsEurope has established a **Multinational Advisory Group (MAG)** which delivers advice on pension issues to PensionsEurope. It provides a collective voice and information sharing for the expertise and opinions of multinationals.

## What PensionsEurope stands for

- A regulatory environment encouraging workplace pension membership;
- Ensure that more and more Europeans can benefit from an adequate income in retirement;
- Policies which will enable sufficient contributions and good returns.

## Our members offer

- Economies of scale in governance, administration and asset management;
- Risk pooling and often intergenerational risk-sharing;
- Often “not-for-profit” and some/all of the costs are borne by the employer;
- Members of workplace pension schemes often benefit from a contribution paid by the employer;
- Wide-scale coverage due to mandatory participation, sector-wide participation based on collective agreements and soft-compulsion elements such as auto-enrolment;
- Good governance and alignment of interest due to participation of the main stakeholders.

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[1] EU Member States: Austria, Belgium, Bulgaria, Croatia, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Netherlands, Portugal, Romania, Spain, Sweden. Non-EU Member States: Iceland, Norway, Switzerland, UK.