

# Transparency and integrity of Environmental, Social and Governance (ESG) rating activities

2023/0177(COD) - 13/06/2023 - Legislative proposal

**PURPOSE:** to lay down a consistent and effective regime to address the shortcomings and vulnerabilities that environmental, social, and governance ratings pose.

**PROPOSED ACT:** Regulation of the European Parliament and of the Council.

**ROLE OF THE EUROPEAN PARLIAMENT:** the European Parliament decides in accordance with the ordinary legislative procedure and on an equal footing with the Council.

**BACKGROUND:** environmental, social, and governance (ESG) investing, that is, investing which takes ESG factors into account when making investment decisions, is becoming an important part of mainstream finance. Notably, investment funds with sustainable characteristics or objectives have largely increased in number, size and the type of capital they attract. In this context, an ESG investment ecosystem has developed, including amongst others the supply of ESG ratings. Such ESG ratings are marketed as **providing an opinion on the exposure of a company or entity to environmental, social and/or governance factors**, and their impact on society.

The current ESG rating market suffers from **deficiencies** and is not functioning properly, with users' and rated entities' needs regarding ESG ratings not being met and confidence in ratings undermined. This problem has a number of different dimensions, mainly (i) the lack of transparency on the characteristics of ESG ratings, their methodologies and their data sources and (ii) the lack of clarity on how ESG rating providers operate. Therefore, ESG ratings do not serve their purpose and do not sufficiently enable users, investors and rated entities to take informed decisions as regards ESG-related risks, impacts and opportunities.

Hence, the Commission committed in the renewed sustainable finance strategy adopted in July 2021, to take action to improve the reliability, comparability and transparency of ESG ratings.

**CONTENT:** this proposal aims to introduce a **common regulatory approach to enhance the integrity, transparency, responsibility, good governance, and independence of ESG rating activities**, contributing to the **transparency and quality** of ESG ratings. It aims to contribute to the smooth functioning of the internal market, while achieving a high level of consumer and investor protection and preventing greenwashing or other types of misinformation, including social-washing, by introducing transparency requirements related to ESG ratings and rules on the organisation and conduct of ESG rating providers.

More specifically, this proposal aims to enhance the **quality of information** about ESG ratings, by (i) improving transparency of ESG ratings **characteristics and methodologies** to enable investors to make better informed investment decisions in regard to sustainability objectives, and by (ii) ensuring increased clarity on operations of ESG rating providers and the prevention of risks of conflict of interest at ESG rating providers' level.

As supervisor of the ESG rating providers under this proposal, the **European Securities and Markets Authority** (ESMA) would be the appropriate body to take stock of the developments and highlight potential issues of concern, liaising with relevant national authorities in the Member State where ESG ratings are used and where ESG rating providers are located and have their operations.

### ***Budgetary implications***

This proposal empowers ESMA to carry out a new function, namely to authorise and supervise ESG rating providers providing their services under this Regulation. This will require ESMA to charge ESG rating providers fees, which should cover all administrative costs incurred by ESMA for its authorisation and supervision activities. The total annual cost increase is estimated at approximately EUR 3.7-3.8 million. This cost will not be borne by EU budget.