AmCham EU
SPEAKING FOR AMERICAN BUSINESS IN EUROPE

Our position

Environmental, Social and Governance Ratings

AmCham EU speaks for American companies committed to Europe on trade, investment and competitiveness issues. It aims to ensure a growth-orientated business and investment climate in Europe. AmCham EU facilitates the resolution of transatlantic issues that impact business and plays a role in creating better understanding of EU and US positions on business matters. Aggregate US investment in Europe totalled more than €3.7 trillion in 2022, directly supports more than 4.9 million jobs in Europe, and generates billions of euros annually in income, trade and research and development.

American Chamber of Commerce to the European Union
Speaking for American business in Europe

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Executive summary

The American Chamber of Commerce to the European Union (AmCham EU) supports a well-functioning global capital market which integrates environmental, social and governance (ESG) considerations. The proposal to introduce a regulation on the transparency and integrity of ESG rating activities (ESG Ratings Regulation) can support this objective if it takes a proportionate approach to implementing the international standards developed by the International Organization of Securities Commissions (IOSCO).

With this objective in mind, the draft text of the regulation can be improved during the co-legislative process in the following ways:

1. The scope of the regulation and the separation of business requirements should be clarified so that it is clear to rated companies, ESG rating providers and ESG rating users which activities relating to the analysis of ESG would require a new authorisation by the European Securities and Markets Authority (ESMA) under the regulation.

2. The third-country regime should be amended to remove the arbitrary revenue threshold that would prevent international providers of ESG ratings from using the recognition route.

3. The provisions of the regulation on safeguarding the independence of ESG rating methodologies from external interference should be maintained, in line with the IOSCO recommendations.

4. As this is a new regulated activity with a high degree of uncertainty on definitions, it is critical that firms subject to the regulation have an appropriate amount of time to prepare their businesses for authorisation. The regulation should be amended to provide a more reasonable implementation period.

Introduction

The European Commission published a proposal on a Regulation on transparency and integrity of ESG rating activities in June 2023, as part of its renewed sustainable finance strategy. ESG rating activities can play an important role in the EU sustainable finance market, as they provide information to investors and financial institutions, and the proposal aims to improve the reliability, comparability and transparency of ESG ratings. In order to reach these objectives, the policymakers should refine the proposal, as explained below, in the following four areas: the scope and separation of business requirements, third-country regime, safeguarding independence and implementation period.

1. Scope and separation of business requirements

The scope of the ESG Ratings Regulation is not clear. As a result, it is difficult to determine which activities, products, services and analysis would fall under the definition of 'ESG rating' or 'ESG rating provider' and would therefore be subject to the requirements of the regulation. In particular, what it means to 'offer', 'issue' and/or 'distribute' a rating is unclear. Consequently, it is unclear which entities would need to apply for an authorisation. The proposed scope also appears to be in tension with the proposed list of exclusions, and it is difficult to determine whether a firm or its activities would be subject to the regulation, excluded from the scope of the regulation or prohibited from providing ESG

ratings altogether. Determining the relevant threshold and criteria for including products in scope of the regulation is challenging given the very broad range of ESG analytical tools in the market. For that reason, the criteria should take a risk-based approach and focus, with due and proportionate regard for a fair playing field, on those products which amount to an identifiable opinion on ESG matters according to a defined rating or ranking scale.

For example, an ESG controversy alert which includes features that meet the criteria outlined in the regulation's definition of an ESG rating (eg an opinion or score related to ESG with a defined ranking system based on an established methodology) would presumably be captured by the scope. An explicit inclusion reference to such a category of controversy alert products in the text of the regulation may benefit users and providers of ESG ratings in understanding that these products would be in scope should they meet the relevant criteria.

By the same token, clear safe harbours for firms complying with ESG disclosure requirements prescribed by EU regulations should be provided to avoid duplicative or conflicting rules. The publication of required ESG disclosure (which may include metrics) under separate EU regulations would presumably not be captured under this regulation. For example, disclosure of Principle Adverse Impact indicators prescribed under the Sustainable Finance Disclosure Regulation (SFDR), ESG disclosure under the Corporate Sustainability Reporting Directive (CSRD) or ESG-related disclosures under the Benchmarks Regulation – among others – should not be considered to amount to the production or distribution of an 'ESG rating'.

Even with clear criteria to determine what an ESG rating is, the scope of the regulation is potentially very broad. As a result, the separation of business requirements in Article 15 should be amended to take a more proportionate approach with regard to the identification of potential conflicts of interest rather than requiring an ex-ante separation of all other activities. Unless addressed, providers offering products that do not pose material risks of conflict of interest could be required to undertake costly legal restructuring to continue to provide these products. This could significantly hinder growth and innovation in this nascent market.

2. Third-country regime

To scale up the mobilisation of private capital towards sustainable investments, it is crucial to consider how further predictability and comparability concerning ESG ratings products can be accomplished across jurisdictions. To this end, the EU should ensure that any further steps taken in this area are coordinated with international stakeholders and based on international recommendations, notably IOSCO.

There is a risk of market fragmentation, which could exacerbate issues relating to ESG disclosure and ESG information, if any policy actions in the ESG ratings space are not based on the recommendations of IOSCO. In particular, legislative action in the EU with respect to other products used in financial markets (such as benchmarks) has resulted in significant difficulties, as other jurisdictions have not adopted equivalent frameworks.

The European Commission's proposed third-country regime for ESG rating providers, which would deny ESG rating providers above a certain revenue threshold the ability to use the recognition route, is concerning. It is unclear why the ESG ratings regulation would introduce a more restrictive third-country regime than the EU Benchmarks Regulation when the latter has been widely recognised as not functioning. Given that the EU Benchmarks Regulation is currently under review to fix the

problems with the third-country regime, the co-legislators should align the ESG ratings regulation's third-country regime to include the recognition route for all providers.

More fundamentally, the proposal in the third-country regime to recognise equivalent regulatory regimes other jurisdictions will, for the foreseeable future, benefit very few (if any) third-country providers because no other jurisdiction has yet introduced an equivalent regime, and is unlikely to do so for several years. The third-country regime should be revised to provide a more principles-based approach to third-country provider access to the EU market.

3. Safeguarding independence

AmCham EU supports the need to ensure the independence and objectivity of ESG ratings, as they are key tenets of investor protection. It is important for ESG rating providers to remain independent and free from conflicts of interests. The disclosure and management of conflicts of interests should be an important consideration for ESG rating providers and for potential policy initiatives in this space.

The inclusion of strong safeguards on the independence of ESG rating providers' methodologies, in line with the Final IOSCO Recommendations, is a positive development. These provisions should be maintained at the core of the regulation and the co-legislators should refrain from introducing constraints on methodologies that would amount to selecting criteria through regulation.

4. Timelines and implementation period

As this regulation would introduce a new regulated activity, it is essential that firms within scope have enough time to prepare for authorisation and supervision. This is particularly the case for third-country providers which may not currently have an established presence in the EU.

As drafted, the timelines would likely not provide sufficient time for such entities to adapt to the requirements proposed in the regulation. The combination of a broadly defined scope, the uncertainty on which activities are covered, the extensive separation of business requirements, the highly restrictive third-country regime and the disclosure requirements would present significant challenges to all firms but especially those that do not currently have a significant presence in the EU.

Conclusion

ESG ratings can be a key part of the transition to a sustainable economy as they provide investors and financial institutions with much-needed information. To ensure the success of the new ESG Ratings Regulation, the policymakers should clarify its scope and the separation of business requirements, refine the third-country regime, maintain the provisions on safeguarding the independence of ESG rating methodologies and give firms subject to the regulation an appropriate amount of time to prepare for authorisation. The American business community stands ready to provide the co-legislators with any further information and looks forward to contributing to future discussions.