

01 September 2023

Sven Gentner
Head of Unit
Directorate-General for Financial Stability, Financial Services and Capital Markets Union
European Commission
1049 Brussels
Belgium

Submitted via file upload

Dear Mr Gentner,

Proposal for a Regulation of the European Parliament and of the Council on the Transparency and Integrity of Environment, Social and Governance (ESG) Rating Activities

MSCI¹ welcomes the opportunity to provide feedback to the European Commission (“the Commission”) on its Proposal for a Regulation on the Transparency and Integrity of Environment, Social and Governance (ESG) Rating Activities (the “Proposal”). As a leading global provider of ESG ratings, MSCI is well positioned to comment on the proposed measures. We operate to the highest standards of ethical conduct in assigning ESG ratings and agree that it is important that ESG ratings are, and are seen to be, credible. Below we offer our observations on the Proposal and suggest adjustments in order to provide further clarity and alignment with the underlying objectives of the Proposal.

The Proposal correctly focuses on ESG Ratings and excludes ESG data

We welcome that the Proposal focuses on ESG ratings and does not scope in “ESG data”.² The inclusion of “ESG data” would create an overly broad regulatory framework, including companies that publish information on their own ESG profile, a government agency that tracks and publish Greenhouse Gas Emissions, a journalist that publishes information on an ESG profile of a company or even a national weather service. Defining boundaries and/or devising rules across so many different types of data sources is not feasible, stifles innovation and slows down the rapid evolution of solutions to assist the market in understanding and measuring ESG risk and opportunities.

Principle of ‘same activity, same risk and same regulation’

While we welcome that the Proposal captures all ESG ratings disclosed publicly, including ESG ratings disclosed to clients,³ it is also important to recall the principle ‘*same activity, same risk and same regulation*’. Going forward, publicly disclosed ESG ratings should only be produced by ESMA-authorized and supervised ESG rating providers, regardless of the entity that produces them (i.e., asset managers, financial services companies, non-profits). If the scope of the Regulation was changed to exclude certain entities distributing proprietary ratings to the public or to their clients (including retail clients), there is a very real risk of

¹ MSCI ESG Ratings, research and data are produced by MSCI ESG Research LLC.

² Article (2)(1) of the Proposal.

³ *Id.*

outcomes that would undermine the intent behind the legislative intervention and would lead to unlevel playing fields and the exposure of retail investors to material conflicts of interest.

The independence of ESG ratings is critically important and must be preserved

The Proposal includes a critical provision that clearly states public authorities must not interfere in the content of ESG ratings and ESG methodologies.⁴ We strongly support this measure, but note that interference in ESG ratings could manifest in at least two ways, including:

(a) Interference in an ESG rating outcome by issuers, investors and/or governments

It is important that ESG rating providers are not placed under any undue pressure by issuers, investors, regulators or government officials or other stakeholders in assigning an ESG rating. Only where ESG rating providers are able to withstand pressure and publish their truly held opinion without any perception of interference will investors have confidence in the integrity of the rating.

(b) Interference in the rating methodology

Regulation should not seek to harmonise ESG ratings or methodologies. Diversity of opinion demonstrates a dynamic and competitive market where investors have choices to select ratings that reflect their investment strategy. A mandated one-size fits-all approach to ESG ratings would reduce the thoroughness, innovation, insights, effectiveness and evolution of the ratings.

In order to more fully preserve the independence of ESG ratings and methodologies and to protect against interference from a range of potential stakeholders, we recommend:

- (a) extending the non-interference with the content of ratings or methodologies in Article 26 to include data sources, as well as clarifying that 'users' and 'rated entities' shall not interfere with the content of ESG ratings or their methodologies.
- (b) limiting the complaints-handling process in Article 18 of the Proposal to 'rated entities' and tightening the criteria to those that relate to the rating process (i.e., complaints regarding factual errors, new information and/or confidential information).

Transparency should not infringe on intellectual property

Disclosure requirements should be tailored to achieve transparency without compromising intellectual property. For example, Article 21 (1) requires the disclosure to the public of proprietary ESG rating models while the provision in Annex III 1 (f) could be interpreted to require disclosure of ESG rating-specific weighting. Additionally, Annex III 1 (b) requires public disclosure of an ESG rating provider's data process. Such disclosure would require ESG rating providers to disclose their intellectual capital, intellectual property, know-how and

⁴ Article 26 of the Proposal.

the results of their innovation that qualify as trade secrets, which would conflict with Article 14 (12) of the Proposal.⁵

Therefore, we recommend deleting the requirements to disclose models in Article 21 (1), ESG rating weighting in Annex III 1 (f) as well as information related to data processing in Annex III 1 (b).

FRANDT principles should be applied equally across all parts of the investment ecosystem

With respect to fees charged by ESG rating providers, the Proposal calls for fair, reasonable, transparent and non-discriminatory treatment of users of ESG ratings, but also introduces an exceptional requirement that fees be “based on cost”.⁶ ESG rating providers source data from data vendors which do not have to comply with the “based on cost” principle. ESG ratings users (e.g., asset managers) also do not have to comply with “based on cost” when selling their financial services and products which make use of ESG ratings.

This concern extends to the requirement in Annex III(1)(j) where ESG rating providers will be required to disclose an unprecedented level of information to the public regarding the cost base (e.g., IT equipment and purchasing data). This is a significant and extraordinary level of intrusion into the determination of fees by the ESG rating providers.

We also note that the introduction of “based on costs”:

- (i) has not been subject to wider consultation by the Commission,
- (ii) was not a policy option considered in the Commission’s Impact Assessment⁷,
- (iii) goes beyond what is strictly necessary to obtain the public policy object, and
- (iv) is not in line with the proportionality principle.

Therefore, we recommend deleting the requirements “based on cost” in Article 25 (1) and (2) as well as the requirement in Annex III (1) (j) around detailed cost disclosure.

Sufficient time is needed to implement the new regulatory requirements

The Proposal anticipates that ESG rating providers submit an application to ESMA within 6 months after entry into force.⁸ This is unachievable and unrealistic given that the industry is currently not subject to regulation. ESMA will be required to consult and provide the European Commission with at least six sets of Level 2 measures for review and adoption,

⁵ Article 14(12) of the Proposal states that “ESG rating providers shall not disclose information about their intellectual capital, intellectual property, know-how or the results of innovation that would qualify as trade secrets as defined in Article 2, point (1), of Directive (EU) 2016/943 of the European Parliament and of the Council.” See also Directive (EU) 2016/943 of the European Parliament and of the Council of 8 June 2016 on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure (OJ L 157, 15.6.2016, p. 1).

⁶ Article 25 of the Proposal.

⁷ See Commission Staff Working Document Impact Assessment Report accompanying Proposal for a Regulation of the European Parliament and of the Council on the transparency and integrity of Environmental, Social and Governance (ESG)rating activities available at <https://ec.europa.eu/info/law/better-regulation/>.

⁸ See Articles 48 and 50 of the Proposal.

which will have to be scrutinised by the EU co-legislators.⁹ ESG ratings providers will require the details of these Level 2 regulatory requirements to make the necessary internal and external preparations to apply to ESMA. Therefore, we propose:

- (i) the application of the Regulation is linked to the publication of the Level 2 measures in the Official Journal of the EU i.e., application of the Level 1 Regulation after 12 months post publication of all relevant Level 2 measures, or
- (ii) the Regulation applies 18 months after entry into force.

We look forward to continued engagement with the Commission on the Proposal. Please do not hesitate to contact us with any queries.

Yours faithfully,

/s
Nicolas Kügler
Vice President
Head of External Affairs (EMEA)

⁹ These include Article 5 (3), Article 11 (8), Article 21 (3), Article 22 (3), and Article 27 (2), and Article 40 (2).