Insurance Europe response to EC proposal on ESG rating activities

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Insurance Europe welcomes the EC proposal to improve the availability, integrity and transparency of environmental, social and governance (ESG) rating activities. The planned introduction of regulatory standards for rating activities should improve the quality of information on ESG ratings and address existing shortcomings in the ESG rating market.

Nevertheless, there are several areas in which improvements should be made to promote transparency, comparability and integrity while ensuring a level regulatory playing field and fostering competition, not only in the ESG ratings market but also in terms of ESG data itself.

1. Include raw ESG data products in the scope of the Regulation

Reliable and comparable ESG data is, in a similar way to ESG ratings, a precondition for the proper functioning of the EU sustainable finance market. For many investors and providers of financial products, ESG raw data and other ESG data products (hereafter "ESG data products") play an even more important role than ESG ratings. The high demand results, *inter alia*, from the regulatory reporting obligations for financial market participants under the Sustainable Finance Disclosures Regulation (SFDR) and the EU Taxonomy Regulation, but also exists to support the proper implementation of sustainable investment strategies and the management of sustainability risks. At the same time, Insurance Europe sees similar shortcomings in ESG ratings — in particular the lack of common standards, binding requirements and transparency, which limit the quality of the data.

The lack of common standards and binding requirements leads to the use of approximations and estimates and to different results and it ultimately limits the quality of ESG data products. At the same time, the methods and data sources used are often not made sufficiently transparent, which is particularly problematic for users and ultimately for supervision when approximations and estimates are used. These shortcomings not only weaken users' confidence in the accuracy of the data but also increase their risk of being subject to greenwashing allegations or even breaching European regulation. Investors are dependent on comparable and trustworthy ESG data.

Better comparability and improved reliability, as envisaged for ESG ratings, is thus also needed for ESG data. The scope of the regulation should therefore also include the provision of ESG data products.

In its November 2021 report, IOSCO highlighted the importance of ESG data to the financial market and called for an oversight of ESG ratings as well as data product providers. As the draft regulation already refers to the corresponding IOSCO definition for ESG ratings, it should also refer to the IOSCO definition for ESG data products, which considers ESG raw data as a type of ESG data product.

Furthermore, while the Corporate Sustainability Reporting Directive (CSRD)/European Sustainability Reporting Standards (ESRS) will improve the availability and reliability of ESG data for EU issuers in the future, such regulation for ESG data is still necessary. Without adequate regulation, significant data gaps will remain, at least in relation to non-EU companies, and ambiguity about the quality and reliability of the data will persist, as the different approaches used in generating data (including estimates or approximations and methodologies) will remain unclear to the user of such data. Although such ESG data will be made available through the European Single Access Point (ESAP) in the future, this would not be a sufficient solution to insurers' data needs; the disclosed data and ultimately the data provided by data providers would not automatically become more reliable and comparable.

Therefore, ESG data products (including ESG raw data) should fall within the scope of the regulation in the same way as ESG ratings. The proposed regulation on ESG rating activities would be a suitable regulatory framework since ESG data is usually collected and processed by ESG rating providers. The proposed requirements for ESG rating providers and their products could serve as a blueprint for the regulation of ESG data products so that they are subject to similar requirements as ESG ratings, in particular with regard to transparency, fees and the avoidance of conflicts of interest.

To achieve the proposed extension of the scope of the regulation to ESG data products, the insurance industry proposes the following:

- Adjustment of Article 2 (1) and deletion of the exemption in Article 2 (2) c), adding the following:

  *"ESG data products": refer to the broad spectrum of data products, **including estimates**, that are marketed as providing either a specific E, S, or G focus or a holistic ESG focus on an entity, financial instrument, product or company's ESG profile or characteristics or exposure to ESG, climatic or environmental risks or impact on society and the environment, whether or not they are explicitly labelled as "ESG data products".*

  According to IOSCO's report, ESG raw data is a type of ESG data product. To avoid misunderstandings, it should be clarified in the proposed EC regulation that the definition of ESG data products includes ESG raw data.

- Extending specific obligations of the proposed regulation, in particular transparency requirements (Article 21) and complaints-handling mechanisms (Article 18) to the provision of ESG data products.

2. Include the entire group of ESG rating providers in the regulation

To discourage anti-competitive behaviour and to avoid circumventions as seen in the credit rating industry, it is essential to ensure that the regulation on ESG rating activities does not create loopholes. It is particularly important to include the whole ESG rating agency group (ie, including all subsidiaries) in the regulation and to ensure that there are no possibilities for circumvention in the involvement of third parties, in particular in the dissemination of ESG ratings and ESG data via licensing agreements with unregulated group companies.

3. Disclosure requirements

Insurers welcome the proposals to increase the transparency of the rating methodologies and data sources used. Information to be disclosed according to Annex III No.2 should not only be addressed to the rated entity or subscribers. It should also reach users of the ratings, eg, institutional investors. Disclosure obligations must apply in full, regardless of whether the user receives the rating directly from the ESG rating agency, an affiliated company or a third party. To avoid misunderstandings, Art. 22 should be clarified accordingly by replacing the word "subscriber" with the word "user".

4. Ensure non-discriminatory access to ESG ratings, including for private investors

Investors should have non-discriminatory access to ratings. In this regard, insurers welcome the proposed Art. 13 and recital 19 requiring information on ESG ratings and ESG rating providers to be made available on the ESAP. This will allow investors to have more insights into ratings and enable smaller institutional investors and retail investors to better include ESG ratings in their investment decisions and, for example, demand rating information on investment platforms.

5. Clear definition of "financial products"

The EC proposal lacks a clear definition of financial products. It only requires that where an ESG rating relates to a financial product, the ESG rating provider meets the regulation's requirements, without defining financial products. Insurance Europe suggests that the proposed regulation explicitly defines financial products in Art. 3 to eliminate any ambiguity.

In order to have a coherent regulatory framework and considering that all sustainable finance regulations should be integrated, the definition of financial products as stated in Art. 2 paragraph 12 of the SFDR could be considered. Nevertheless, the definition there appears to be very limited for banking products and would therefore probably have to be expanded for the purposes of this regulation.

In addition, for insurance-based investment products (IBIPs), multi-option products (IBIPs offering a range of investment options) it should be clarified that ESG ratings are applied only at product level.

6. Transitional provisions

The implementation deadlines and transitional periods should be chosen so that it is possible for EU and non-EU agencies to set up the necessary, legal organisational structures. The transitional periods currently envisaged appear to be too short for this purpose and may need to be adjusted.

7. Risk of market concentration with oligopolistic structures

While the regulation's provision for fee control is appreciated, Insurance Europe is concerned about potential market concentration and its impact on competition. The ESG ratings and data market already exhibits a few large players alongside smaller specialised companies. To avoid a similar market concentration seen in credit ratings, the regulation should not impose price restrictions, which would lead smaller or new companies to consider that an investment in such a data and model structure would not be worthwhile. A well-functioning market should foster competition among several non-dominant players. To contain the oligopolistic structures that are already emerging or exist, it seems particularly important that fees are based on actual costs as proposed in the draft regulation. In addition, consideration could be given to incorporating references to EU competition law provisions, prohibiting abuse of dominant market positions or unreasonable pricing practices.

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