The ESG Ratings Regulation Final Report Card

Finance Watch

Name of EU institution: European Commission, Council of the European Union and European Parliament

Grading period: April 2024

TOPIC	*GRADE*	*FINANCE WATCH FEEDBACK*
Authorisation	A	EU ESG rating providers operating in the EU must apply for an authorisation and will be supervised by ESMA. A necessity to ensure an effective and harmonized enforcement of the rules.
Third country providers	B Keep an eye on equivalence	The Regulation provides a level playing field by allowing non-EU providers to operate in the EU if one of the following conditions is met: • The third country has an equivalent legal regime. • An EU provider of the same group endorses the ratings and is authorized by ESMA. The minimum substance requirements will prevent EU empty shells. • The provider has a limited size and is recognized by ESMA. However, a third country regime with no authorization process could be considered as equivalent.
Separation of E, S & G factors	A Excellent!	ESG ratings providers will be required to disclose standalone assessments of the E, S and G components of ESG ratings. This prevents confusing situations where an enterprise with quality governance and good social policies, but a disastrous environmental impact, can have a high ESG rating. Very good achievement!
Transparency	A Not far from excellent	Rating providers must disclose whether: • The rating covers the financial materiality and the impact materiality. • The rating is expressed in absolute or relative values. • The rating is correlated with the Taxonomy alignment (if the rating covers the E factor). Would be excellent if publicly disclosed ratings were subject to more detailed public disclosures. We also count on ESMA to develop disclosure templates to allow comparability.
Separation of activities	B	The safeguards and the separation of ESG rating activities from audit, consulting, benchmark and credit rating activities will reduce potential risks of conflicts of interest. Main risks will be covered.
Inclusion of financial sector	D Just ok	The adaptation of SFDR to include transparency requirements for ESG ratings distributed by asset managers reduces the unlevel playing field. Yet the governance and transparency requirements are limited and the ratings provided under research services are still exempted.
Conflicts of interests at staff level	B	Provisions on the holding of financial instruments and on the acceptance of management position at a rated entity are a good step forward to prevent staff conflicts of interest.