UK HMT– Future Regulatory Regime for ESG ratings providers

Consultation Paper Responses

First Sentier Investors (FSI) is an asset management business and the home of investment teams FSSA Investment Managers, Igneo Infrastructure Partners, Realindex Investments and Stewart Investors. Our vision is to be a provider of world-leading investment expertise and client solutions, led by our responsible investment principles. We are stewards of assets under management of US$148.1 billion (as at 31/03/23) across listed equities, fixed income and direct infrastructure on behalf of institutional investors, pension funds, wholesale distributors and platforms, financial advisers and their clients. Our purpose is to deliver sustainable investment success for the benefit of our clients, employees, society and our shareholder and our vision is to be a provider of world-leading investment expertise and client solutions, led by our responsible investment principles and based on a culture driven by our core values: Care, Openness, Collaboration and Dedication.

#	Question	FSI Response
Q1	Do you agree that regulation should be introduced for ESG ratings providers?	First Sentier Investors would agree that there is a need for regulatory intervention as well as greater transparency and reliability in the market. We support the view that ESG ratings play an important role in the sustainable finance marketplace. It is necessary to ensure that ESG ratings provide decision-useful information to users. Quality and reliability of information is integral to support this. Quality is often impacted by how data is collected, the frequency of data updates and verification. We would recommend that HM Treasury consider a higher-level transparency of rating methodologies as a key component of the UK's regulatory regime. The majority of ESG rating providers do provide general methodologies, however, there are a range of underlying assumptions, criteria and models, raw data inputs, relative factor weightings and time horizons used which remain undisclosed to external users. Any regulation should clearly set out expectations around transparent disclosure of

#	Question	FSI Response
		information that underpins methodologies and demonstration that methodologies are being followed. A specific area where we see minimal transparency of methodology is regarding forward-looking ESG ratings such as Implied Temperature Rise (ITR), which assigns a specific temperature in degrees Celsius to show temperature alignment of a company or portfolio, or Climate Value-At-Risk (CVaR). We do acknowledge a certain level of protection of ratings providers 'intellectual property' or sensitive information as a given and that ratings providers will want to retain control of their methodologies, processes and business models. As such, we do *not* believe regulation should determine how methodologies are constructed or force full disclosure where such disclosure would harm competitiveness. Regulation should also provide for transparency on conflicts of interest as most major providers do issue ratings but also have a corporate solutions arm, as acknowledged in IOSCO's final report on ESG data and rating providers. Any conflicts should be disclosed in a timely manner. We strongly support an internationally coordinated approach that has regard to IOSCO's overall recommendations. We would also encourage engagement with the EU as the region looks to develop similar regulations for ratings providers.
Q3.	Are there any practical challenges arising from overlap between potential regulation for ESG ratings providers and existing regulation?	The publication of specific timelines as well as envisaged phases for both initiatives from Treasury and FCA would be welcomed. One of the primary regulatory overlaps is between HM Treasury's consultation on ESG ratings and the ongoing work of the industry-led, voluntary 'Code of conduct'. We believe that a clearer vision will be required from policymakers on the inter-links between the two initiatives, the extent to which they will be integrated as well as their respective objectives.
Q4	Are there any other practical challenges to introducing such regulation?	A practical challenge that will need to be addressed is the potential for delays in both scoping and implementing a proposed regulation. Early and continued engagement, through the design phase, with both ESG rating providers and users of ratings will be integral to minimising uncertainty and general delays. We are supportive of the

#	Question	FSI Response
		establishment of the FCA's ESG Data and Ratings Code of Conduct Working Group (DRWG) which includes participants from industry. We recommend Treasury draw on the work of the Code of Conduct, and the lessons learned, as it progresses over time. Corporate data - ESG Ratings are heavily dependent on raw data inputs. Whilst the level and quality of reported corporate data is expected to improve, including future adoption of ISSB, it is anticipated that subjective estimates will remain a key element to determining ESG ratings. Regulation will need to clearly set out expectations around the disclosure of methodologies where estimation models are used. A further practical challenge could be determining what is a sufficient level of resources to maintain high-quality ESG rating assessment i.e. personnel and technological resources. Should providers maintain resources dependent on the number of corporates covered by ESG ratings?
Q5	Do you agree with the proposed description of an ESG rating?	In the interest of international alignment, we would recommend that Treasury, at a minimum, consider the definition of ESG rating as set out in Article 3 of the EU's Proposals for transparency and integrity of ESG ratings activities. Acknowledgement of other regional definitions should also be considered.
Q6	Do you agree that ESG data, where no assessment is present, should be excluded from regulation?	We support the exclusion of ESG data, where no assessment or opinion is present, from regulation.
Q12	Do you agree with the proposal to regulate the direct provision of ratings to users in the UK, regardless of the location of the provider?	We broadly agree with the proposal to capture the direct provision of ESG ratings to users in the UK, by both UK firms and overseas firms. We recommend considering equivalence arrangements with the EU and other jurisdictions to ensure that ESG ratings are not unduly restricted to users in the UK, and to retain a competitive market.

#	Question	FSI Response
Q13	(For UK users of ESG ratings) Are you concerned that this proposal would hamper the choice of ESG ratings available to you?	We are not overly concerned that the proposal would hamper the choice of ESG ratings available to us. On the contrary, we believe regulation of ESG ratings will provide for more clarity, transparency, and certainty within the industry as users look to assess the merits and sophistication of each provider. As noted in the IOSCO recommendations report, implementation of oversight measures could contribute to a greater level of confidence in the usage of ratings products.
Q16	How would the territorial scope proposed in this chapter interact with initiatives related to ESG ratings in other jurisdictions, such as proposals for regulation or codes of conduct?	As noted above, we recommend Treasury engage closely, and align where possible, with the EU and other jurisdictions where similar regulations or codes of conduct are being developed. We note that Singapore has this month become the latest jurisdiction to publish a proposed Code of Conduct for ESG ratings providers.
Q17	Should smaller ESG ratings providers be subject to fewer or less burdensome requirements?	We support the views outlined in the paper suggesting a proportionate approach for smaller providers. It is beneficial to have measures that support smaller-sized ESG rating providers to enable them to continue their activities without being overburdened, both from a costs and compliance perspective. Nevertheless, a baseline of minimum standards should apply to all ratings providers regardless of size.