The European Voice of Directors

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The 3rd of June 2022,

Subject: Comment letter to the European Commission targeted consultation on the functioning of the ESG ratings market in the European Union and on the consideration of ESG factors in credit ratings

Dear Mr Gentner,

The European Confederation of Directors' Associations (ecoDa), which represents the main national institutes of directors in Europe (and more than 55.000 individual board members), fully backs the European Commission's objectives to foster the reliability, trust and comparability of ESG ratings as underlined in its related consultation. As the role and influence of ESG ratings in the market is continuously growing especially for investors, those entities cannot be left unregulated and unsupervised. The subject is too important for the European Union to let the profession self-regulate as it is the case for proxy advisors which continues to raise a lot of concerns for companies.

The ongoing consultation specifically targets ESG ratings and credit ratings, however given that board members oversee the non-financial information and take into consideration ratings to possibly adapt their strategy, we would like to address some key recommendations:

- ecoDa would encourage **a principle-based regulation** in order not to hamper innovation and concentration in the market ;
- We are pleading for **greater transparency and clarity on the methodologies** adopted (topics covered, weight given to the metrics used, number of data points used...) but also on terminologies used by ESG ratings. This lack of disclosures of the procedures often leads to different hardly understandable assessments. It is all the more problematic that methodologies are often adapted and reviewed in light of current hot topics resulting in confusion and difficulties for companies to provide a clear overview of their performance over the years. There should also be a **description of how ESG rating agencies collect and manage the data** (do they make use of artificial intelligence or algorithms, where do they get the input, what are the external sources of information, etc).

Without uniformizing the approach ESG ratings should follow (the variety of focus areas and cultural differences should be acknowledged), the regulators should incentivize convergence through transparency requirements. A distinction between ESG ratings should be made whether they are conducted from a risk or a reporting perspective;We suggest that any methodology used should **include an industry analysis** to identify its general features , overview of the company in scope, specific overview for the group companies (to have the entire picture) ;

- We insist on the need for **ESG ratings to cover the three dimensions** (E, S and G) and not to neglect somehow the governance aspect (which should not be confused with corporate governance);
- The methodology should also include **a review of prior ratings and ratings from other agencies** to identify misinterpretations. This should have a virtuous effect of enhancing quality over time, with a clear understanding of differences (case of Wirecard rated fairly high on ESG) ;
- ESG ratings should be clear on **what is meant by good performance** and they should provide information on their benchmark reference. We are calling for **more engagement** between ESG rating providers and companies even if it has a cost. It is essential that rating providers understand the business strategy as well as the sector and the context in which companies are evolving furthermore when companies are in a transitional phase. In the context of the due diligences to be performed (see EFRAG ED ESRS), more intensive questioning by the rating agencies is expected. Rating agencies will have to get professionalized on these subjects in order to develop proper impact analyses, not to rely only on provided data but to engage with companies through interviews. Their role is pivotal in creating a level playing-field at sector level and in creating the conditions for “enforcement” by other non-financial (eg. NGO, through name-and-shame actions) and financial actors. Therefore, ESG ratings should be communicated by the rating agency to the company, with a contact person (for any modification required as from time to time there can be misunderstandings in how the information is analysed, and it is usually very difficult to directly approach a contact person at the rating agency to address comments). It is important to establish two-way communication.
- Methodologies should be discussed as well as **credentials of the people involved in making the assessment** (alongside the engagement with companies). We suggest certain certification/accreditation for the contact person to be considered;
- **Ethics codes should be defined as well as specific training**, to make sure that professional scepticism is applied in the interviews. This also goes with researching the sectors before making interview ;
- A regulation should ensure that ESG ratings **are free from conflicts of interests** and that **a system for questioning the assessments** is organized. Rating agencies should disclose the name of experts used in the assessment (if any), as well as a statement that they are free of conflict of interests (and the ethics code should define the independence criteria) ;
- Filling out all the information requested by ESG ratings is time-consuming. The regulator should make sure that **ESG ratings act in a proportionate way** and do not increase the burden on companies;
- We encourage the regulator to define minimum quality standards for both data considered in ratings and the rating themselves to ensure their reliability and credibility;

- ecoDa would like to attract your attention to the fact that most of the players are now American (S&P, acquisition of Oekom by ISS, Vigeo-Eiris by Moody's, Sustainalytics by Morningstar). There is no point in Europe in developing a sophisticated regulatory framework if standards are fixed outside.

We remain at your disposal for any further details on our opinion.

Sincerely yours,

Béatrice Richez-Baum,
Director General

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Chair