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**PROPOSAL**

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No. Cion doc.:	COM(2023) 314 final/2
Subject:	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

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Delegations will find attached document COM(2023) 314 final/2.

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Encl.: COM(2023) 314 final/2



Brussels, 7.7.2023  
COM(2023) 314 final/2

2023/0177 (COD)

**CORRIGENDUM**

This document corrects COM(2023)314 final of 13.6.2023

Concerns the EN version only

Minor editing corrections which do not affect the substance of the text

The text shall read as follows:

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**

(Text with EEA relevance)

{SEC(2023) 241 final} - {SWD(2023) 204 final} - {SWD(2023) 207 final}

## **EXPLANATORY MEMORANDUM**

### **1. CONTEXT OF THE PROPOSAL**

#### **• Reasons for and objectives of the proposal**

This proposal is an integral part of the European Commission's renewed sustainable finance strategy adopted in July 2021.<sup>1</sup>

Environmental, social, and governance (ESG) investing, that is, investing which takes ESG factors into account when making investment decisions (also referred to as sustainable investments), is becoming an important part of mainstream finance. Notably, investment funds with sustainable characteristics or objectives have largely increased in number, size and the type of capital they attract. In this context, an ESG investment ecosystem has developed, including amongst others the supply of ESG ratings. Such ESG ratings are marketed as providing an opinion on the exposure of a company or entity to environmental, social and/or governance factors, and their impact on society.

ESG ratings have an increasingly important impact on the operation of capital markets and on investor confidence in sustainable products. In particular, ESG ratings play an enabling role for the proper functioning of the EU sustainable finance market by providing critical sources of information for investment strategies, risk management and disclosure obligations by investors and financial institutions. They are also used by undertakings who seek to better understand sustainability risks and opportunities linked to their activities or those of their partners, and for comparison to their peers.

The market of ESG ratings is expected to continue to grow substantially in the coming years. Growth and increase in demand for ESG ratings is driven by the changing nature of risks to companies, by growing investor awareness of the financial implications of those risks and by the growth in investment products that explicitly seek to meet certain sustainability standards or achieve certain sustainability objectives. It is also linked to the sustainable finance legislation put forward by the EU since 2018.

However, the current ESG rating market suffers from deficiencies and is not functioning properly, with investors and rated entities' needs regarding ESG ratings are not being met and confidence in ratings is being undermined. This problem has a number of different facets, mainly (i) the lack of transparency on the characteristics of ESG ratings, their methodologies and their data sources and (ii) the lack of clarity on how ESG rating providers operate. ESG ratings do not sufficiently enable users, investors and rated entities to take informed decisions as regards ESG-related risks, impacts and opportunities.

Hence, the Commission committed in the renewed sustainable finance strategy, to take action to improve the reliability, comparability and transparency of ESG ratings. More specifically, this proposal aims to enhance the quality of information about ESG ratings, by (i) improving transparency of ESG ratings characteristics and methodologies, and by (ii) ensuring increased clarity on operations of ESG rating providers and the prevention of risks of conflict of interest at ESG rating providers' level. Since ESG ratings and underlying data are used for investment decisions and allocation of capital, the general objective of the initiative is to improve the

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<sup>1</sup> Communication from the Commission on the Strategy for Financing the Transition to a Sustainable Economy COM(2021) 390 final.

quality of ESG ratings to enable investors to make better informed investment decisions in regard to sustainability objectives. It will also enable rated entities to take informed decisions about managing ESG risks and the impact of their operations. At the same time, it is crucial to foster trust and confidence in the operations of ESG rating providers by ensuring that the market operates properly and ESG rating providers prevent and manage conflicts of interest.

This proposal does not intend to harmonise the methodologies for the calculation of ESG ratings, but to increase their transparency. ESG rating providers will remain in full control of the methodologies they use and will continue to be independent in their choice, to ensure that a variety of approaches are available in the ESG ratings market (i.e. ESG ratings may differ amongst themselves and cover different areas).

This proposal aims to make it easier to exploit the potential of the European Single Market and the Capital Markets Union and to contribute to the transition towards a fully sustainable and inclusive economic and financial system in accordance with the European Green Deal<sup>2</sup> and UN Sustainable Development Goals.

Significant investment is required across all sectors of the economy to transition to a climate-neutral economy and reach the Union's environmental sustainability objectives. It should be made easier for investors and undertakings to identify environmentally sustainable investments and ensure that they are credible.

The present initiative is not a regulatory fitness and performance programme (REFIT) initiative.

- **Consistency with existing provisions in the policy area**

The EU has put in place the building blocks for a sustainable finance framework<sup>3</sup>. Stakeholders are now pointing out remaining market inefficiencies and regulatory gaps that could hinder the development of the market. ESG rating providers and data providers use information published by undertakings; the availability, accuracy and consistency of this data are key to the quality of the downstream products that depend on it. Under the Corporate Sustainability Reporting Directive (CSRD)<sup>4</sup> and the EU Taxonomy Regulation<sup>5</sup>, undertakings are required to produce information on specific ESG factors. ESG ratings will build on and complement that by providing critical sources of information for investment strategies, risk management and internal analysis by investors and financial institutions. ESG rating providers use data coming from undertakings, and the more reliable, accurate and standardised data that is available, the less need there is to use estimations to fill in the gaps. For instance, corporate sustainability reports will facilitate the assessments carried out by the ESG rating providers.

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<sup>2</sup> Communication from the Commission on the European Green Deal, COM(2019) 640 final.

<sup>3</sup> These building blocks are: 1) a classification system, or 'taxonomy', of sustainable activities, 2) a disclosure framework for non-financial and financial undertakings, and 3) investment tools, including benchmarks, standards and labels.

<sup>4</sup> Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting.

<sup>5</sup> Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.

In addition, the new requirements imposed on financial institutions and market participants by the sustainable finance legislation (such as the CSRD, Sustainable Finance Disclosure Regulation<sup>6</sup> and the EU Taxonomy Regulation) will lead to an increased demand for ESG ratings.

This initiative also interacts with the work on green bonds standards and EU climate benchmarks. Regarding the proposal for a European Green Bond Regulation,<sup>7</sup> issuers of future EU green bond standards are required to disclose the taxonomy-alignment of projects funded by their bonds. For that purpose, they may seek ESG ratings to obtain underlying data that would feed into their projects assessments. The information disclosed in ESG ratings helps investors, including green bond investors, to better assess the overall non-financial performance of undertakings.

As for the EU Climate Benchmark Regulation,<sup>8</sup> a Delegated Regulation<sup>9</sup> lays down a list of ESG factors to be disclosed by benchmark administrators, for those benchmarks that pursue ESG objectives, depending on the type of underlying assets concerned (e.g. equity, fixed income, sovereign). They will have to source the information directly from undertakings (e.g. via their annual reports) or obtain this information from external rating/data providers. The Delegated Regulation gives benchmark administrators the option of disclosing information on ESG ratings of the benchmarks. Better information on the methodologies used for ESG ratings should help provide benchmark administrators with clarity regarding the constituents of the benchmarks. Better, more reliable ratings will build benchmark administrators' trust, and eventually improve the adoption of those ratings as a reliable tool for designing meaningful benchmarks. Further, it will help benchmark users to ensure they identify benchmarks that are aligned with their investment strategy and help them to implement it, avoiding risks of greenwashing. This Regulation should also improve the confidence of investors in ESG benchmarks and, thus further support sustainable investing.

- **Consistency with other Union policies**

This proposal is part of a package of sustainable finance measures that is a priority under the Capital Markets Union project. It contains measures to harness the transformative power of financial services and to shift private capital towards sustainable investment. It contributes to the development of more integrated capital markets by making it easier for investors to benefit from the single market whilst taking better informed decisions. For instance, the European Single Access Point (ESAP) gives stakeholders easier access to data, and can also serve as a source of information / input data for ESG rating providers, reducing the use of estimations but also contributing to better quality of ratings overall.

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<sup>6</sup> Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability- related disclosures in the financial services sector.

<sup>7</sup> Proposal for a Regulation of the European Parliament and of the Council on European green bonds, COM/2021/391 final.

<sup>8</sup> Commission Delegated Regulation (EU) 2020/1818 of 17 July 2020 supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council as regards minimum standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks.

<sup>9</sup> Commission Delegated Regulation (EU) 2020/1816 of 17 July 2020 supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council as regards the explanation in the benchmark statement of how environmental, social and governance factors are reflected in each benchmark provided and published.

This proposal also complies with the overarching policy goals of the European Green Deal. The European Green Deal is the Union's response to the generation-defining climate and environment-related challenges. It aims to transform the Union into a modern, resource-efficient and competitive economy with no net emissions of greenhouse gases by 2050.

Furthermore, a fully functioning and integrated market for capital will allow the EU's economy to grow in a sustainable way and be more competitive, in line with the strategic priority of the Commission for an Economy that Works for People, focused on creating the right conditions for job creation, growth and investment.

This proposal complements the existing EU environmental and climate policies by making the methodologies for ESG ratings more transparent, which should lead to the more efficient channelling of investment towards sustainable assets.

## **2. LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY**

### **• Legal basis**

This proposal falls within the area of shared competence in accordance with Article 4(2)(a) of the Treaty on the Functioning of the European Union (TFEU) and is based on Article 114 TFEU, which confers on the EU competence for laying down appropriate provisions for the establishment and functioning of the internal market.

Article 114 TFEU allows the Union to take measures not only to eliminate existing obstacles to the exercise of the fundamental freedoms, but also to prevent the likely emergence of such obstacles in the future. This includes obstacles that make it difficult for market participants, such as ESG rating providers or investors, to take full advantage of the benefits of the internal market.

### **• Subsidiarity (for non-exclusive competence)**

The objective of this initiative, to improve clarity as to the characteristics and objectives of ESG ratings and the operations of ESG rating providers, cannot be adequately achieved by Member States acting independently and thus action at EU level is necessary for the proper functioning of EU capital markets.

There is currently no EU regulatory framework for ESG rating providers. Member States do not regulate the activities of ESG rating providers or the conditions under which they provide ESG ratings. Each ESG rating provider follows its own rules, with a lack of clarity as to what they do and how they do it.

The ESG ratings market is global. Some large ESG providers have their headquarters in the EU, whereas many others are headquartered outside the EU but have subsidiaries within the EU.

Although Member States could individually take action to strengthen the reliability and transparency of ESG ratings, such measures are likely to differ significantly between Member States. This may create diverging levels of transparency, barriers for market participants and challenges for those operating across borders (as they do in the EU market, with users across a number of Member States), in addition to limiting comparability between ratings. Alternatively, with no rules at all on the operations of ESG rating providers, the current situation and the transparency issues relating to transparency would continue and could even worsen.

With sustainable investing and ESG ratings attracting increasing attention in jurisdictions around the world, it is becoming essential for the EU to engage with its partners on the basis of a coherent and comprehensive harmonised approach. The initiative would not replace

national legislation as currently no Member State has legislation regulating the functioning of ESG rating providers.

The functioning of the internal market would be improved by greater clarity about the operations of entities that are increasingly important for channelling finance.

- **Proportionality**

This proposal complies with the principle of proportionality as set out in Article 5 TFEU. The proposed measures are necessary to achieve the objectives, and also the most suitable.

The proposal focuses on the activities of providers of ESG ratings operating in the EU. It addresses market shortcomings, namely: (a) the lack of clarity on the characteristics of ESG ratings, the methodologies used and data sources, and (b) the lack of clarity about, and control of, operations of ESG rating providers.

This proposal goes no further than is necessary to address and remedy each of these issues in the most effective way, namely by: (1) creating an authorisation system that would apply to ESG rating providers operating in the EU, subjecting them to proportionate rules governing their operations and ongoing proportionate supervision, and (2) requiring ESG rating providers operating in the EU to publish key information about ESG rating characteristics and methodologies, and disclose granular methodological information to their subscribers and to rated entities.

This proposal does not include in-house ratings developed by asset managers or other institutions such as benchmark administrators, as they are used for own decisions and investments and do not serve the same purpose and are not subject of public disclosure or distribution by subscription or other means.

As a result, This initiative will target legal persons providing ESG ratings to the public or to subscribers. It will not cover financial institutions or other market participants developing ESG ratings for their own purposes or own use.

- **Choice of the instrument**

This proposal aims to put in place a system that would improve clarity as to the characteristics of ESG ratings. To that effect, it sets rules for ESG rating providers operating in the EU. The proposal seeks to make it easier to better exploit the potential of the European single market and to contribute to the transition towards a fully sustainable and inclusive economic and financial system in line with the European Green Deal and UN Sustainable Development Goals. A regulation is necessary to achieve these policy objectives and is the best way to improve clarity as to operations by entities that are increasingly important for channelling finance.

A regulatory framework would be aligned with the approach taken for other financial market participants and relevant legislation, e.g. the EU Benchmark Regulation, Credit Rating Agencies Regulation and EU Green Bond Standard proposal that provide for ongoing supervision and lay down a number of organisational requirements and requirements concerning governance processes and documents. Other tools such as soft law measures and codes of conduct would only partially achieve the objectives of this initiative, since there would be no incentive to produce a sufficiently rigorous code of conduct. Existing market pressures would determine the rigour and comprehensiveness of a code, and those pressures have proven insufficient to address the problems. Moreover, a code of conduct would be voluntary. Some providers might choose not to adopt it, or multiple industry codes might arise. Both cases would undermine any prospect of greater clarity across the market for users or rated entities.

### 3. RESULTS OF *EX-POST* EVALUATIONS, STAKEHOLDER CONSULTATIONS AND IMPACT ASSESSMENTS

- ***Ex-post* evaluations/fitness checks of existing legislation**

Not applicable.

There is currently no EU-level legal regime for ESG ratings.

- **Stakeholder consultations**

The Commission has gathered a significant amount of evidence from different sources, including a study commissioned by the European Commission's Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA), a Commission consultation and outreach activities and exchanges with stakeholders. The European Securities and Markets Authority (ESMA) also supported the Commission's work via a call for evidence published in 2022 and provided a mapping of ESG rating providers operating in the EU. The Commission also analysed existing international recommendations and codes for ESG rating providers, in particular the recommendations from the International Organization of Securities Commissions (IOSCO). A total of 168 organisations and private individuals responded to the targeted consultation supporting this initiative, mainly investors, ESG rating providers and listed companies.

- **Collection and use of expertise**

To better understand the problems which the market faces in practice, and following the targeted consultation, the Commission has undertaken a major review of academic literature<sup>10</sup>, market analysis and outreach activities with a large number of key stakeholders in the ESG ratings market.

Between April and October 2022, the Commission held bilateral meetings with various stakeholders, including 14 different ESG rating providers, users, and associations representing, among others, rating users, academics, non-governmental organisations, public bodies and supervisory authorities.

The Commission also held regular calls with ESMA for its opinion and advice, including on a potential authorisation and supervision regime for ESG rating providers at EU level.

- **Impact assessment**

This proposal is accompanied by an impact assessment<sup>11</sup>, which was submitted to the Regulatory Scrutiny Board (RSB) on 16 November 2022 and, received a positive opinion with reservations on 16 December.

The impact assessment concludes that the key problem is two-fold: while investors and undertakings observe issues with the reliability, accuracy and timeliness of ESG ratings, rated entities are unsure which categories/criteria are used to assess them and how accurately ESG ratings reflect their actual performance and how to improve it.

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<sup>10</sup> See Section 2 on the Impact Assessment's problem definition.

<sup>11</sup> Commission Staff Working Document SWD (2023) [XXX].



There are several consequences of this problem. The **consequences from a user's perspective** are:

- (1) Investors are unable to take sufficient account of sustainability-related and other non-financial risks and opportunities in their investment decisions,
- (2) Investors are also less able to channel financial resources to undertakings and economic activities that address and do not exacerbate social and environmental problems,
- (3) Benchmark administrators construct benchmarks based on ESG ratings where they do not have fully clarity over how they were computed,
- (4) Undertakings cannot consider all potential risks and opportunities from their activities and channel investments accordingly.

The **specific consequence from a rated entity perspective** is that they may receive an ESG rating in relation to elements that are outdated or incorrect, which can impact the terms of their access to finance.

The **specific consequence from other stakeholders' perspective** is that non-governmental organisations, trade unions and other stakeholders are less able to hold undertakings accountable for their impacts on society and the environment.

The problems have **negative consequences for the functioning of the EU sustainable finance market**, leaving a gap in the EU sustainable finance framework that was established to provide more transparency and the tools for private capital to flow to sustainable investments that are urgently needed for the transition. The **wider consequences** are that the potential of the European Single Market to contribute to the objectives of the European Green Deal, and to the achievement of the UN Sustainable Development Goals, is not fully utilised.

Two complementary problem drivers were identified:

- (1) Lack of clarity about and control of operations of ESG rating providers.
- (2) Lack of clarity on the characteristics of ESG ratings, their methodologies and their data sources (this includes how they are created and disclosure/transparency on these), and

The impact assessment considered a range of policy options for two main variables:

- increased **clarity on operations of ESG rating providers** and the prevention of risks of **conflict of interest** at ESG rating providers level, and
- the need to **improve clarity of ESG ratings characteristics** (i.e. what they mean and what objectives they pursue, the methodologies and the data sources or estimates used for their development).

Several legislative and non-legislative policy options were analysed for the following two dimensions: entities (ESG rating providers) and products (ESG ratings). Regarding the regulatory treatment of ESG rating providers, the three options considered were an industry code of conduct (Option 1), registration and light supervision (Option 2), and authorisation, principle-based organisational requirements, and risk-based supervision (Option 3). Regarding the extent of transparency requirements on ESG ratings and their methodologies, the two options considered are minimum disclosure requirements to the public (Option 1) and minimum disclosure requirements to the public and more comprehensive disclosure requirements to clients of ESG rating providers and rated entities (Option 2). The analysis also considers carefully their cost-effectiveness and coherence. The following options were

discarded at an early stage: registration and supervision at national level, harmonising methodologies of ESG rating providers, setting minimum requirements on the content of ESG ratings and detailed templates for disclosure requirements.

As to the scope, the definition of ESG ratings by IOSCO would form the basis for the scope of this initiative, covering both scores and ratings, and products which are a mixture of both. This initiative would target the specialised entities providing ESG ratings or scores to the public or to subscribers and would not cover financial institutions or other market participants developing ESG ratings for their own purposes, as they use their own proprietary models and don't provide ESG ratings commercially to other financial market participants.

Based on the comparison of effectiveness, efficiency and coherence, the preferred option would combine Option 3 on ESG rating providers (authorisation, organisational requirements and supervision) together with Option 2 on ESG ratings (minimum transparency disclosures to the general public and more comprehensive disclosures to clients of ESG rating providers and rated entities). The detailed analysis found that the combination of such options would fully address the objectives (unlike the other options) and result in the highest benefits to users and rated entities, and providers themselves and society. Even though the preferred option may entail higher upfront costs, in the long-term the benefits are expected to outweigh the costs.

The preferred option is expected to bring significant economic benefits. This initiative would be expected to positively influence the functioning of financial markets and conditions for ESG investing. The preferred option should enable investors, and rated entities, to understand and make informed ESG choices regarding ratings. It should also reduce the cost of gathering information and the need to use extra providers, thus cutting the cost of doing business. The preferred option would also be non-discriminatory and would apply equally to domestic and non-EU market participants. This initiative may have an impact on the general competitiveness of the ESG rating providers, likely increasing the cost of doing business for them in the short term, but increased trust in ESG ratings could enhance market growth. To mitigate potential concerns about loss of access to the market, a transitional period could be provided for, which would give smaller players in particular more time to adjust. The initiative is also expected to have positive, though marginal, indirect social and environmental impacts.

- **Regulatory fitness and simplification**

The present initiative is not a regulatory fitness and performance programme (REFIT) initiative.

To mitigate costs and impacts of new requirements under this Regulation on smaller providers, the following mitigating measures are proposed.

- (1) Transition period. To mitigate potential concerns about loss of access to market providers due to the authorisation process, providers would be allowed to continue operating on condition that they notify ESMA and become authorised within a pre-determined period of time, i.e. the transitional period.

- (2) Adjustment of supervisory fees to the size of the provider. Fees would be proportionately distributed across providers based on their annual net turnover.
- (3) Proportionate supervision. ESMA has adopted a risk-based, data-driven approach to conducting supervision<sup>12</sup> and prioritises its supervisory activities according to the level of risk identified and the importance/size of supervised entities.
- (4) Possibility for smaller and innovative entities to apply for exemption from a wide range of internal organisational measures, if they can demonstrate the requirements are disproportionate to the nature, scale and complexity of their business and the nature and range of issues assessed by their product (e.g. data-driven rater<sup>13</sup> or innovative, forward-looking rater)<sup>14</sup>.

- **Fundamental rights**

The proposal respects the rights and principles set out in the Charter of Fundamental Rights of the European Union, in particular those in Article 16 (freedom to conduct a business). The free movement of persons, services and establishment is one of the basic rights and freedoms protected by the Treaty on the European Union and the Treaty on the Functioning of the European Union and is relevant for this measure.

#### **4. BUDGETARY IMPLICATIONS**

This proposal empowers ESMA to carry out a new function, namely to authorise and supervise ESG rating providers providing their services under this Regulation. This will require ESMA to charge ESG rating providers fees, which should cover all administrative costs incurred by ESMA for its authorisation and supervision activities. The size of the market is 59 entities: 30 ESG providers based in the EU (3 large, 6 medium-sized, 9 small and 12 micro); and 29 non-EU entities. Based on the estimation that it would take ESMA 1.7 full-time equivalents (FTEs) to supervise a large ESG rating provider and 0.2 FTEs to supervise a small ESG rating provider, we have calculated the need for 20 FTEs annually. Based on the same estimation, ESMA would need 7 temporary agent (AC) posts and 12 CA posts for the authorisation of 30 EU entities and 29 non-EU entities, and the supervision of 30 EU entities and 29 non-EU entities starting from year N+1. We consider it likely that there will be a peak of one-off work in the first year (year N) relating to authorisation. It is important, therefore, that ESMA is given the 19 FTEs from the outset, to manage this peak.

The total annual cost increase is estimated at approximately EUR 3.7-3.8 million. This cost will not be borne by EU budget, as the proposal will enable ESMA to charge ESG rating providers authorisation and supervisory fees, so as to cover all supervisory costs. This is similar to other areas, where ESMA is responsible for the oversight of certain entities (e.g. credit rating agencies). For more details please see the Financial Legislative Statement.

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<sup>12</sup> [ESMA risk-based and data-driven approach when conducting supervision](#)

<sup>13</sup> Small group of quants develop a data-driven ESG ratings model, which has very broad firm coverage from day one.

<sup>14</sup> Innovative, but not revenue-producing business that takes more than seven years from founding to finalise its ESG ratings model.

## 5. OTHER ELEMENTS

### • Implementation plans and monitoring, evaluation and reporting arrangements

The Commission will ensure that the actions selected in this Regulation contribute to achieving the policy objectives with a blend of specific monitoring elements designed to measure efficiency in implementation and progress towards *specific objectives*, but also, other monitoring tools contributing to the *general objectives*. Those elements and tools are further described below. To monitor progress towards meeting the *specific objectives*, the Commission will explore the possibility of organising periodic surveys of investors, undertakings and ESG rating providers.

The surveys would gather data on: (1) users' and rated entities' perceptions of changes in the information available particularly with respect to the specific objectives identified in Section 4, and perceptions as to whether those objectives are being met; and (2) the costs and benefits of ESG rating regulation and oversight from an ESG rating provider's perspective. Such surveys will be dependent on the availability of financial resources.

Progress towards meeting the specific objectives can also be monitored through a number of indicators, such as the number of ESG ratings made available, growth in use of ESG ratings by users and issuers and increase in overall correlation between ESG ratings.

Monitoring progress towards meeting the *general objectives* is by definition considerably more complex since it is methodologically difficult to distinguish the impacts of the proposed measures on ESG ratings from other possible factors. Nevertheless, the Commission proposes to monitor progress regarding the general objectives by:

- monitoring trends in investments in undertakings that carry out sustainable economic activities, covering environmental, social and governance aspects<sup>15</sup>;
- engaging with supervisors and other relevant stakeholders to assess whether concerns of greenwashing involving ESG ratings are being reduced.

It may also be possible to use the proposed surveys of investors, undertakings and ESG rating providers to gather evidence on whether stakeholders perceive that ESG rating providers are more accountable for their activities.

As supervisor of the ESG rating providers under this initiative, ESMA would be the appropriate body to take stock of the developments and highlight potential issues of concern, liaising with relevant national authorities in the Member State where ESG ratings are used and where ESG rating providers are located and have their operations.

In addition, various stakeholders, including civil society organisations, ESG rating providers, business organisations and public authorities, are likely to publish reports that monitor developments in this area, which will be a useful complement to the monitoring carried out by the Commission.

Both the indicators above and surveys will help evaluate whether the preferred policy option is successful in achieving the specified objectives. These indicators will then serve as a basis

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<sup>15</sup> This will be done in close cooperation with the Platform on Sustainable Finance, which will monitor trends regarding capital flows towards sustainable investments as set out in Article 20 of the Taxonomy Regulation.

for an evaluation that should be presented at the latest 5 years after the entry into force of the present initiative. The draft proposal will further contain a commitment to evaluate the impacts of the new legislative act. The Commission will start monitoring implementation of the preferred policy option after the entry into force of the initiative.

- **Explanatory documents (for directives)**

Not applicable.

- **Detailed explanation of the specific provisions of the proposal (to be completed when clarity on articles numbering/reordering)**

Title I lays down the subject matter, scope and definitions applicable to the Regulation. Article 1 sets out the subject matter of the Regulation, namely the introduction of a common regulatory approach to enhance the integrity, transparency, responsibility, good governance and independence of ESG rating activities, contributing to the transparency and quality of ESG ratings provided to regulated European financial undertakings and European undertakings. The Regulation also lays down transparency requirements related to ESG ratings and rules on the organisation and conduct of ESG rating providers. Article 2 relates to the scope of this Regulation, which applies to ESG rating activities provided by ESG rating providers operating in the EU. Article 3 sets out the definitions for the purposes of this Regulation.

Title II of the Regulation sets out the conditions for the provision of ESG ratings in the Union

Article 4 to 8 lay down requirements relating to the process for authorisation of ESG rating providers, including the submission of an application for authorisation, its examination, notification of a decision to authorise, refuse or withdraw an authorisation by ESMA. Article 9 to 12 establishes rules on the provision of ESG ratings in the EU by third country ESG rating providers. Article 9 lays down requirements relating to equivalence decisions, while Article 10 covers requirements on endorsement of ESG ratings and Article 11 lays down requirements on the recognition process. Article 12 concerns cooperation arrangements between ESMA and third country supervisory authorities. Article 13 introduces a requirement for ESMA to maintain a register on its website with all authorised ESG rating providers and provides for requirements on the accessibility of information on the European Single Access Point (ESAP).

Title III of the Regulation sets out the principles on the integrity and reliability of ESG rating activities.

Chapter 1 determines the organisational requirements, processes and documents concerning governance for ESG rating activities. Article 14 lays down the general principles to be followed by ESG rating providers including the need to employ appropriate systems, resources and procedures and ensure the independence of activities. Article 15 requires ESG rating activities to be separated from a number of activities, including the provision of consulting activities, issuance and sale of credit ratings and development of benchmarks. Article 16 lays down in more details the obligations for rating analysts, employees and other persons involved in the provision of ESG ratings. Article 17 introduces requirements on record-keeping related to ESG rating activities. Article 18 then sets out obligations for ESG rating providers to have an independent complaints procedure established to ensure that stakeholders are able to notify them of complaints and that the ESG rating provider objectively evaluates the merits of any complaint. Article 19 introduces requirements and safeguards relating to the outsourcing of some functions related to ESG rating activities to third parties. Article 20 sets out exemptions on governance requirements that can be awarded

by ESMA to those ESG rating providers that are meeting criteria in particular related to their size.

Chapter 2 covers the transparency requirements of ESG ratings' activities. Article 21 introduces the transparency requirements over ESG rating activities to be made available to the public. Article 22 introduces transparency requirements over ESG rating activities to be made available to the subscribers of ESG ratings and to rated entities.

Chapter 3 lays down obligations relating to the independence and conflict of interests of ESG rating providers. Article 23 requires ESG rating providers to have in place robust governance arrangements which include a clear organisational structure with well-defined, transparent and consistent roles and responsibilities for all persons involved in the provision of an ESG rating. Article 24 lays down requirements on the management of potential conflicts of interest by employees involved in the provision of ESG ratings. Article 25 sets out obligations for ESG ratings' fees that are charged to clients to be fair, reasonable, transparent, non-discriminatory and based on actual costs.

Chapter 4, Article 26 to 39, sets out ESMA's powers with regard to the supervision of ESG rating providers. These include the power to request information by simple request or by decision, the power to conduct general investigations and the power to conduct on-site inspections. The chapter also sets out the conditions under which ESMA may exercise its supervisory powers. Several provisions specify the supervisory measures, fines and periodic penalties ESMA may impose. ESMA is also enabled to charge authorisation and supervisory fees.

Chapter 5 lays down principles on cooperation between ESMA and national competent authorities.

Title IV on Delegated and Implementing Acts confers on the Commission the power to adopt delegated acts subject to the conditions laid down in Article 45.

Title V on transitional and final provisions sets out the date by when ESG rating providers should apply for authorisation, also providing for a transitional period for small and medium-sized ESG rating providers that are offering their services prior to the entry into application of the Regulation. It also introduces a transitional period for new entrants to the market that are small and medium sized ESG rating providers.

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**

(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,  
Having regard to the Treaty on the Functioning of the European Union, and in particular Article 114 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Economic and Social Committee<sup>16</sup>,

Acting in accordance with the ordinary legislative procedure,

Whereas:

- (1) On 25 September 2015, the UN General Assembly adopted a new global sustainable development framework: the 2030 Agenda for Sustainable Development<sup>17</sup>, having at its core the Sustainable Development Goals (SDGs). The Commission's Communication of 2016 on the next steps for a sustainable European future<sup>18</sup> links the SDGs to the Union policy framework to ensure that all Union actions and policy initiatives, within the Union and globally, take the SDGs on board at the outset. The European Council conclusions of 20 June 2017<sup>19</sup> confirmed the commitment of the Union and the Member States to the implementation of the 2030 Agenda in a full, coherent, comprehensive, integrated and effective manner and in close cooperation with partners and other stakeholders. On 11 December 2019, the Commission published its communication on 'The European Green Deal'<sup>20</sup>.
- (2) The transition to a sustainable economy is key to ensuring the long-term competitiveness of the Union economy. Sustainability has long been at the heart of the Union project and the Union Treaties give recognition to its social and environmental dimensions.

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<sup>16</sup> OJ C , , p. .

<sup>17</sup> Transforming our World: The 2030 Agenda for Sustainable Development (UN 2015).

<sup>18</sup> COM(2016) 739 final.

<sup>19</sup> CO EUR 17, CONCL. 5.

<sup>20</sup> Communication from the Commission of 11 December 2019 on the European Green Deal, COM(2019) 640 final.

- (3) Achieving SDG objectives in the Union requires the channelling of capital flows towards sustainable investments. It is important to exploit fully the potential of the internal market for the achievement of those goals. In that context, it is crucial to remove obstacles to the efficient movement of capital towards sustainable investments in the internal market and to prevent such obstacles from emerging.
- (4) The EU's approach to sustainable and inclusive growth is anchored in the 20 principles of the European Pillar of Social Rights to ensure a fair transition towards this goal and policies which leave no one behind. Furthermore, the EU social acquis including the Union of Equality Strategies<sup>21</sup> provides standards in the areas of labour law, equality, accessibility, health and safety at work, and anti-discrimination.
- (5) In March 2018, the Commission published its Action Plan 'Financing Sustainable Growth'<sup>22</sup>, setting up its strategy on sustainable finance. The objectives of that Action Plan are to mainstream sustainability factors into risk management and reorient capital flows towards sustainable investment to achieve sustainable and inclusive growth.
- (6) As part of the Action Plan, the Commission commissioned a study entitled "Study on Sustainability Related Ratings, Data and Research"<sup>23</sup> to take stock of the developments in the sustainability-related products and services market, identify the main market participants and highlight potential shortcomings. That study provided an inventory and classification of market actors, sustainability products and services available in the market and an analysis of the use and perceived quality of sustainability-related products and services by market participants. The study highlighted the lack of transparency and accuracy of Environmental, Social and Governance ('ESG') ratings methodologies and the lack of clarity over the operations of ESG rating providers.
- (7) In the framework of the European Green Deal, the Commission put forward a renewed sustainable strategy. The renewed sustainable finance strategy was adopted on 6 July 2021<sup>24</sup>.
- (8) As a follow-up, the Commission announced in the renewed sustainable finance strategy, a public consultation on ESG ratings to feed into an impact assessment. In the public consultation that took place in 2022, stakeholders confirmed concerns with the lack of transparency of ESG ratings methodologies and objectives and clarity over ESG rating activities.
- (9) At international level, the International Organization of Securities Commissions ('IOSCO') has issued a report in November 2021 containing a set of recommendations on ESG ratings providers<sup>25</sup>.

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<sup>21</sup> Gender equality strategy; LGBTIQ equality strategy; Roma strategic framework; Strategy for the Rights of Persons with Disability.

<sup>22</sup> European Commission, Action Plan: Financing Sustainable Growth, COM(2018) 97 final.

<sup>23</sup> European Commission, Directorate-General for Financial Stability, Financial Services and Capital Markets Union, Study on sustainability-related ratings, data and research, Publications Office of the European Union, 2021, <https://data.europa.eu/doi/10.2874/14850>.

<sup>24</sup> Communication from the Commission on the Strategy for Financing the Transition to a Sustainable Economy COM(2021) 390 final.



- (10) ESG ratings play an important role in global capital markets, as investors, borrowers and issuers increasingly use those ESG ratings as part of making informed, sustainable investment and financing decisions. Credit institutions, investment firms, insurance undertakings, assurance undertakings, and reinsurance undertakings, amongst others, often use those ESG ratings as a reference for the sustainability performance or for the sustainability risks and opportunities in their investment activity. Consequently, ESG ratings have a significant impact on the operation of the markets and on the trust and confidence of investors and consumers. To ensure that ESG ratings used in the Union are independent, objective and of adequate quality, it is important that ESG rating activities are conducted in accordance with the principles of integrity, transparency, responsibility, and good governance. Better comparability and increased reliability of ESG ratings would enhance the efficiency of that fast-growing market, thereby facilitating progress towards the objectives of the Green Deal.
- (11) ESG ratings play an enabling role for the proper functioning of the Union sustainable finance market by providing important information for investment strategies, risk management and disclosure obligations by investors and financial institutions. It is therefore necessary to ensure that ESG ratings provide material decision-useful information to the users, and that users of ESG ratings better understand the objectives which ESG ratings pursue and what specific issues and metrics those ratings measure.
- (12) It is necessary to acknowledge the various business models of the ESG rating market. A first business model is the user-paid model, where users are mainly investors that purchase ESG ratings for investment decisions. A second business model is the issuer-pay model, where undertakings purchase ESG ratings for assessing risks and opportunities with their operations.
- (13) Member States neither regulate nor supervise the activities of ESG rating providers or the conditions for the provision of ESG ratings. In ensuring alignment with the objectives of the SDGs and the European Green Deal, and given the existing divergences, lack of transparency and absence of common rules, it is likely that Member States would adopt diverging measures and approaches, which would have a direct negative impact on, and create obstacles to, the proper functioning of the internal market, and be detrimental to the ESG rating market. ESG rating providers issuing ESG ratings for the use of financial institutions and undertakings in the Union would be subject to different rules in different Member States. Divergent standards and market practices would make it difficult to have clarity over the construction of ESG ratings and to compare them, thus creating uneven market conditions for users, causing additional barriers within the internal market, and risking distorting investment decisions.
- (14) This Regulation complements the existing EU sustainable finance framework. Ultimately, ESG ratings should facilitate information flows in order to facilitate investment decisions.

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<sup>25</sup> [IOSCO Report on ESG ratings and data products providers, available at: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD690.pdf.](https://www.iosco.org/library/pubdocs/pdf/IOSCOPD690.pdf)

- (15) Rules on ESG rating providers should not apply to private ESG ratings produced pursuant to an individual order and provided exclusively to the person who placed the order and which are not intended for public disclosure or distribution by subscription or other means. Neither should such rules apply to ESG ratings produced by European financial undertakings that are used for internal purposes. ESG ratings developed by European or national authorities and by central banks should also be exempted from such rules. Finally, such rules should not apply to the provision of ESG data that do not include an element of rating or scoring and are not subject to any modelling or analysis resulting in the development of an ESG rating.
- (16) It is important to lay down rules ensuring that ESG ratings provided by ESG rating providers authorised in the Union are of adequate quality, are subject to appropriate requirements and ensure market integrity. Those rules would apply to overall ESG ratings capturing Environmental, Social and Governance factors, and to ratings that are only looking at a single Environmental, Social or Governance factor or sub-component of that factor.
- (17) Given the use of ESG ratings from providers located outside the Union, it is necessary to introduce requirements based on which third-country ESG rating providers may offer their services in the Union. This is necessary to ensure market integrity, investor protection and proper enforcement. Therefore, three possible regimes are proposed for those third countries ESG rating providers: equivalence, endorsement and recognition. As an overarching principle, supervision and regulation in a third country should be equivalent to Union supervision and regulation of ESG ratings. Therefore, ESG ratings provided by an ESG rating provider located in a third country can only be offered in the Union where a positive decision on equivalence of the third-country regime has been taken by the Commission. However, to avoid any adverse impact resulting from a possible abrupt cessation of the offering in the Union of ESG ratings provided by a third country ESG rating provider, it is also necessary to provide for certain other mechanisms, that is endorsement and recognition. Any ESG rating provider with a group structure should be able to use the mechanism of endorsement for the ESG ratings developed outside the Union, provided they establish, within the group, an authorised ESG rating provider in the Union. Smaller ESG rating providers, within the meaning of the maximum threshold of net turnover to define small undertakings in Directive 2013/34/EU<sup>26</sup>, that generally do not belong to a group, and may not have the means to have a legal entity authorised in the Union, should be able to continue or start offering their services in the Union and should therefore benefit from a lighter regime, that is recognition. Where the third country ESG provider is subject to supervision, appropriate cooperation arrangements should be put in place in order to ensure the proper exchange of information with the relevant competent authority of the third country.

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<sup>26</sup> Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC (OJ L 182, 29.6.2013, p. 19).

- (18) To ensure a high level of investor and consumer confidence in the internal market, ESG rating providers which provide ESG ratings in the Union should be authorised. It is therefore necessary to lay down harmonised conditions for such authorisation and the procedure for the granting, suspension and withdrawal of such authorisation.
- (19) To ensure a high level of information to investors and other users of ESG ratings, information on ESG ratings and ESG rating providers should be made available on the European Single Access Point (ESAP)<sup>27</sup>. ESAP should provide the public with an easy centralised access to such information.
- (20) To ensure the quality and reliability of ESG ratings, ESG rating providers should use rating methodologies that are rigorous, systematic, objective, continuous and subject to validation. ESG rating providers should review ESG ratings methodologies on an on-going basis and at least annually.
- (21) To ensure a higher-level transparency, ESG rating providers should disclose information to the public on the methodologies, models and key rating assumptions which those providers use in their ESG rating activities and in each of their ESG ratings product. In light of the uses of ESG ratings by investors, the rating products should explicitly disclose which dimension of the double materiality the rating addresses, whether it is both material financial risk to the rated entity and the material impact of the rated entity on the environment and society in general or whether it takes into account only one of them. They should also explicitly disclose whether the rating addresses other dimensions. For the same reason, ESG rating providers should provide more detailed information on the methodologies, models and key rating assumptions to subscribers of ESG ratings. That information should enable users of ESG ratings to perform their own due diligence when assessing whether to rely or not on those ESG ratings. Disclosure of information concerning models should however not reveal sensitive business information or impede innovation.
- (22) ESG rating providers should ensure that they provide ESG ratings that are independent, objective and of adequate quality. It is important to introduce organisational requirements ensuring the prevention and mitigation of potential conflicts of interests. To ensure their independence, ESG rating providers should avoid situations of conflict of interest and manage those conflicts adequately where they are unavoidable. ESG rating providers should disclose conflicts of interest in a timely manner. They should also keep records of all significant threats to the independence of the ESG rating provider and that of its employees and other persons involved in the rating process, and the safeguards applied to mitigate those threats. In addition, to avoid potential conflicts of interest, ESG rating providers should not be allowed to offer a number of other services including consulting services, credit ratings, benchmarks, investment activities, audit, or banking, insurance and reinsurance activities. Finally, to prevent, identify, eliminate or manage and disclose any conflicts of interest and ensure the quality, integrity and thoroughness of the ESG rating and review process at all times, ESG rating providers should establish appropriate internal

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<sup>27</sup> Regulation (EU) XX/XXXX of the European Parliament and of the Council establishing a European Single Access Point (ESAP) providing centralised access to publicly available information of relevance to financial services, capital markets and sustainability (OJ L [...], [...], p. [...]).

policies and procedures in relation to employees and other persons involved in the rating process. Such policies and procedures should, in particular, include internal control mechanisms and a compliance function.

- (23) To bring more clarity and to enhance trust on the operations of ESG rating providers, it is necessary to lay down requirements for ongoing supervision of ESG rating providers at Union level. To ensure a level playing field in terms of on-going supervision and to eliminate the risk of regulatory arbitrage across Member States, the European Securities and Markets Authority (ESMA) should be entrusted with the exclusive responsibility for such authorisation and supervision. At the same time, such exclusive responsibility should optimise the allocation of supervisory resources at Union level, thus making ESMA the centre of supervision.
- (24) ESMA should be able to require all information necessary to carry out its supervisory tasks effectively. It should therefore be able to demand such information from ESG rating providers, persons involved in ESG rating activities, rated entities and third parties to whom the ESG rating providers have outsourced operational functions and persons otherwise closely and substantially related or connected to ESG rating providers or ESG rating activities.
- (25) ESMA should be able to perform its supervisory tasks, and in particular to compel ESG rating providers to end an infringement, to supply complete and correct information, or to comply with an investigation or an on-site inspection. To ensure that ESMA is able to perform those supervisory tasks, ESMA should be able to impose penalties or periodic penalty payments.
- (26) Given its role to authorise and supervise ESG rating providers, ESMA should develop draft regulatory technical standards that do not involve policy choices for submission to the Commission. ESMA should specify further the information needed for the authorisation of ESG rating providers. The Commission should be empowered to adopt those implementing technical standards by means of delegated acts pursuant to Article 290 TFEU and in accordance with Articles 10 to 14 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council<sup>28</sup>.
- (27) In its role to authorise and supervise ESG rating providers, ESMA should be able to charge supervisory fees to supervised entities. Such fees should be paid by the supervised entities.
- (28) In order to specify further technical elements of this Regulation, the power to adopt acts in accordance with Article 290 of the Treaty on the Functioning of the European Union should be delegated to the Commission in respect of the specifications of the procedure impose fines or periodic penalty payments, including provisions on rights of defence, temporal provisions, the collection of fines or periodic penalty payments, and detailed rules on the limitation periods for the imposition and enforcement of penalties and the type of fees, the matters for which fees are due, the amount of the fees, and the

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<sup>28</sup> Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).

manner in which those fees are to be paid. It is of particular importance that the Commission carry out appropriate consultations during its preparatory work, including at expert level, and that those consultations be conducted in accordance with the principles laid down in the Inter-institutional Agreement of 13 April 2016 on Better Law-Making<sup>29</sup>. In particular, to ensure equal participation in the preparation of delegated acts, the European Parliament and the Council should receive all documents at the same time as Member States' experts, and their experts should systematically have access to meetings of Commission expert groups dealing with the preparation of delegated acts.

- (29) It is necessary to have a number of measures supporting smaller ESG rating providers to enable them to continue their activities, or to enter the market after the date of application of this Regulation. Such measures should include the possibility for ESMA to exempt smaller ESG rating providers from a number of organisational requirements where they meet certain criteria. In addition, a transitional regime should be introduced for the first months following the application of this Regulation, to facilitate the initial phase of application for smaller ESG rating providers. Finally, supervisory fees should be proportionate to the annual net turnover of the ESG ratings provider concerned.
- (30) Since the objectives of this Regulation cannot be sufficiently achieved by the Member States, namely to lay down a consistent and effective regime to address the shortcomings and vulnerabilities that ESG ratings pose, but can rather, by reasons of the scale and effects, be better achieved at Union level, the Union may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty on European Union. In accordance with the principle of proportionality as set out in that Article, this Regulation does not go beyond what is necessary in order to achieve those objectives.
- (31) This Regulation should apply without prejudice to the application of Articles 101 and 102 TFEU,

HAVE ADOPTED THIS REGULATION

## TITLE I

### **SUBJECT MATTER, SCOPE AND DEFINITIONS**

#### *Article 1*

##### **Subject-matter**

This Regulation introduces a common regulatory approach to enhance the integrity, transparency, responsibility, good governance, and independence of ESG rating activities, contributing to the transparency and quality of ESG ratings. It aims to contribute to the smooth functioning of the internal market, while achieving a high level of consumer and investor protection and preventing greenwashing or other types of misinformation, including

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<sup>29</sup> OJ L 123, 12.5.2016, p. 1.

social-washing, by introducing transparency requirements related to ESG ratings and rules on the organisation and conduct of ESG rating providers.

## *Article 2*

### **Scope**

1. This Regulation applies to ESG ratings issued by ESG rating providers operating in the Union that are disclosed publicly or that are distributed to regulated financial undertakings in the Union, undertakings that fall under the scope of Directive 2013/34/EU of the European Parliament and of the Council, or Union or Member States public authorities.
2. This Regulation does not apply to any of the following:
  - (a) private ESG ratings which are not intended for public disclosure or for distribution;
  - (b) ESG ratings produced by regulated financial undertakings in the Union that are used for internal purposes or for providing in-house financial services and products;
  - (c) the provision of raw ESG data that do not contain an element of rating or scoring, and is not subject to any modelling or analysis resulting in the development of an ESG rating;
  - (d) credit ratings issued pursuant to Regulation (EC) No 1060/2009 of the European Parliament and of the Council<sup>30</sup>;
  - (e) products or services that incorporate an element of an ESG rating;
  - (f) second-party opinions on sustainability bonds;
  - (g) ESG ratings produced by Union or Member States' public authorities;
  - (h) ESG ratings from an authorised ESG rating provider that are made available to users by a third party;
  - (i) ESG ratings produced by central banks that fulfil all of the following conditions:
    - (a) they are not paid for by the rated entity;
    - (b) they are not disclosed to the public;
    - (c) they are provided in accordance with the principles, standards and procedures which ensure the adequacy, integrity and independence of rating activities, as provided for by this Regulation, and
    - (d) they do not relate to financial instruments issued by the respective central banks' Member States.

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<sup>30</sup> Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (OJ L 302, 17.11.2009, p. 1).

### Article 3

#### Definitions

For the purposes of this Regulation, the following definitions apply:

- (1) ‘ESG rating’ means an opinion, a score or a combination of both, regarding an entity, a financial instrument, a financial product, or an undertaking’s ESG profile or characteristics or exposure to ESG risks or the impact on people, society and the environment, that are based on an established methodology and defined ranking system of rating categories and that are provided to third parties, irrespective of whether such ESG rating is explicitly labelled as ‘rating’ or ‘ESG score’;
- (2) ‘opinion’ means an assessment that based on a rules-based methodology and defined ranking system of rating categories, involving directly a rating analyst in the rating process or systems process;
- (3) ‘score’ means a measure derived from data, using a rule-based methodology, and based only on a pre-established statistical or algorithmic system or model, without any additional substantial analytical input from an analyst;
- (4) ‘ESG rating providers’ means a legal person whose occupation includes the offering and distribution of ESG ratings or scores on a professional basis;
- (5) ‘regulated financial undertaking in the Union’ means an undertaking, regardless of its legal form, that is:
  - (i) a credit institution as defined in Article 4(1), point (1), of Regulation (EU) No 575/2013 of the European Parliament and of the Council<sup>31</sup>;
  - (ii) an investment firm as defined in Article 4(1), point (1), of Directive 2014/65/EU the European Parliament and of the Council<sup>32</sup>;
  - (iii) an alternative investment fund manager (AIFM) as defined in Article 4(1), point (b), of Directive 2011/61/EU of the European Parliament and of the Council<sup>33</sup>, including a manager of a qualifying venture capital fund as defined in Article 3, point (c) of Regulation (EU) No 345/2013 of the European Parliament and of the Council<sup>34</sup>, a manager of a qualifying social entrepreneurship fund as defined in Article 3,

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<sup>31</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

<sup>32</sup> Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173, 12.6.2014, p. 349).

<sup>33</sup> Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (OJ L 174, 1.7.2011, p. 1).

<sup>34</sup> Regulation (EU) No 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds (OJ L 115, 25.4.2013, p. 1).

point (c) of Regulation (EU) No 346/2013 of the European Parliament and of the Council<sup>35</sup> and a manager of the ELTIF as defined in Article 2, point (12) of Regulation (EU) 2015/760 of the European Parliament and of the Council<sup>36</sup>;

- (iv) an undertaking for collective investment in transferable securities (UCITS) management company as defined Article 2(1), point (b), of Directive 2009/65/EC of the European Parliament and of the Council<sup>37</sup>;
- (v) an insurance undertaking as defined in Article 13, point (1), of Directive 2009/138/EC of the European Parliament and of the Council<sup>38</sup>;
- (vi) a reinsurance undertaking as defined in Article 13, point (4), of Directive 2009/138/EC;
- (vii) an institution for occupational retirement provision as defined in Article 1, point (6) of Directive 2016/2341 of the European Parliament and of the Council<sup>39</sup>;
- (viii) pension institutions operating pension schemes which are considered to be social security schemes covered by Regulation (EC) No 883/2004 of the European Parliament and of the Council<sup>40</sup> and Regulation (EC) No 987/2009 of the European Parliament and of the Council<sup>41</sup>, and any legal entity set up for the purpose of investment of such social security schemes;
- (ix) an alternative investment fund (AIF) managed by an AIFM as defined in Article 4(1), point (b), of Directive 2011/61/EU or an AIF supervised under the applicable national law;
- (x) a UCITS as defined in Article 1(2) of Directive 2009/65/EC;

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<sup>35</sup> Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds (OJ L 115, 25.4.2013, p. 18).

<sup>36</sup> Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds (OJ L 123, 19.5.2015, p. 98).

<sup>37</sup> Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (OJ L 302, 17.11.2009, p. 32).

<sup>38</sup> Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ L 335, 17.12.2009, p. 1).

<sup>39</sup> Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs) (OJ L 354, 23.12.2016, p. 37).

<sup>40</sup> Regulation (EC) No 883/2004 of the European Parliament and of the Council of 29 April 2004 on the coordination of social security systems (OJ L 166, 30.4.2004, p. 1).

<sup>41</sup> Regulation (EC) No 987/2009 of the European Parliament and of the Council of 16 September 2009 laying down the procedure for implementing Regulation (EC) No 883/2004 on the coordination of social security systems (OJ L 284, 30.10.2009, p. 1).



- (xi) a central counterparty as defined in Article 2, point (1), of Regulation (EU) No 648/2012 of the European Parliament and of the Council<sup>42</sup>;
- (xii) a central securities depository as defined in Article 2(1), point (1), of Regulation (EU) No 909/2014 of the European Parliament and of the Council<sup>43</sup>;
- (xiii) an insurance or reinsurance special purpose vehicle authorised in accordance with Article 211 of Directive 2009/138/EC;
- (xiv) a ‘securitisation special purpose entity’ as defined in Article 2, point (2), of Regulation (EU) No 2017/2402 of the European Parliament and of the Council<sup>44</sup>;
- (xv) an insurance holding company as defined in Article 212(1), point (f), of Directive 2009/138/EC or a mixed financial holding company as defined in Article 212(1), point (h), of Directive 2009/138/EC, which is part of an insurance group that is subject to supervision at the level of the group pursuant to Article 213 of that Directive and which is not exempted from group supervision pursuant to Article 214(2) of that Directive;
- (xvi) a payment institution as defined in Article 1(1), point (d), of Directive (EU) 2015/2366 of the European Parliament and of the Council<sup>45</sup>;
- (xvii) an electronic money institution as defined in Article 2, point (1), of Directive 2009/110/EC of the European Parliament and of the Council<sup>46</sup>;
- (xviii) a crowdfunding service provider as defined in Article 2(1), point (e), of Regulation (EU) 2020/1503 of the European Parliament and of the Council<sup>47</sup>;

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<sup>42</sup> Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (OJ L 201, 27.7.2012, p. 1).

<sup>43</sup> Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 (OJ L 257, 28.8.2014, p. 1).

<sup>44</sup> Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 (OJ L 347, 28.12.2017, p. 35).

<sup>45</sup> Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC (OJ L 337, 23.12.2015, p. 35).

<sup>46</sup> Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC (OJ L 267, 10.10.2009, p. 7).

- (xix) a crypto-asset service provider as defined in Article 3(1), point (8), of [the proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets<sup>48</sup>] where performing one or more crypto-asset services as defined in Article 3(1), point (9), of [the proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets];
  - (xx) a trade repository as defined in Article 2, point (2), of Regulation (EU) No 648/2012;
  - (xxi) a securitisation repository as defined in Article 2, point (23), of Regulation (EU) 2017/2402;
  - (xxii) an administrator of benchmarks as defined in Article 3(1), point (3), of Regulation (EU) 2016/1011 of the European Parliament and of the Council<sup>49</sup>;
  - (xxiii) a credit rating agency as defined in Article 3(1), point (b), of Regulation (EC) No 1060/2009;
- (6) ‘rating analyst’ means a person who performs analytical functions for the purpose of issuing ESG ratings;
  - (7) ‘rated entity’ means a legal person, a financial instrument, a financial product or a public authority or a body governed by public law which is explicitly or implicitly rated in the ESG rating or score, irrespective of whether such rating has been requested for and irrespective of whether the legal person has provided information for that ESG rating or score;
  - (8) ‘user’ means a natural or legal person, including a public authority or a body governed by public law, to which an ESG rating is provided;
  - (9) ‘competent authorities’ means the authorities designated by each Member State for the purposes of this Regulation;
  - (10) ‘senior management’ means the person or persons who effectively direct the business of the ESG rating provider and the member or members of the ESG rating provider’s administrative or supervisory board.
  - (11) ‘group of ESG rating providers’ means a group of undertakings established in the Union consisting of a parent undertaking and its subsidiaries within the meaning of Article 2 of Directive 2013/34/EU, and undertakings linked to each other by a relationship and whose occupation includes the provision of ESG ratings.

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<sup>47</sup> Regulation (EU) 2020/1503 of the European Parliament and of the Council of 7 October 2020 on European crowdfunding service providers for business, and amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937 (OJ L 347, 20.10.2020, p. 1).

<sup>48</sup> COM/2020/593 final.

<sup>49</sup> Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 (OJ L 171, 29.6.2016, p. 1).

TITLE II  
**PROVISION OF ESG RATINGS IN THE UNION**

*Article 4*

**Requirements to provide ESG ratings in the Union**

Any legal person who wishes to provide ESG ratings in the Union shall be subject to either of the following:

- (a) an authorisation issued by ESMA as referred to in Article 5;
- (b) an implementing decision as referred to in Article 9;
- (c) an authorisation for endorsement as referred to in Article 10.
- (d) a recognition as referred to in Article 11;

CHAPTER 1

**Authorisation to provide ESG ratings in the Union**

*Article 5*

**Application for an authorisation to provide an ESG rating**

1. Legal persons established in the Union that wish to provide ESG ratings in the Union shall apply for authorisation to ESMA.
2. The application for authorisation shall contain all of the information listed in Annex I and shall be submitted in any of the official languages of the Union. Council Regulation No 1<sup>50</sup> shall apply mutatis mutandis to any other communication between ESMA and the ESG rating providers and their staff.
3. ESMA shall develop draft regulatory technical standards to specify further the information listed in Annex I.

ESMA shall submit those draft regulatory technical standards to the Commission by XX XXXX XXXX.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with the procedure laid down in Articles 10 to 14 of Regulation (EU) No 1095/2010.

4. An authorised ESG rating provider shall comply with the conditions for initial authorisation at all times.
5. ESG rating providers shall notify ESMA of any material changes to the conditions for initial authorisation, including any opening or closing of a branch within the Union, without undue delay.

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<sup>50</sup> Council Regulation No 1 determining the languages to be used by the European Economic Community (OJ 17, 6.10.1958, p. 385).

## *Article 6*

### **Examination of the application for authorisation of ESG rating providers by ESMA**

1. Within 30 working days of receipt of the application referred to in Article 5(2), ESMA shall assess whether the application is complete. Where the application is not complete, ESMA shall set a deadline by which the applicant is to provide additional information.
2. After having assessed whether an application is complete, ESMA shall notify the applicant of the result of that assessment.
3. Within 120 working days of the notification referred to in paragraph 2, ESMA shall adopt a fully reasoned decision to authorise or refuse authorisation.
4. ESMA may extend the period referred to in the paragraph 3 to 140 working days in particular where the applicant:
  - (a) envisages endorsing ESG ratings as referred to in Article 10;
  - (b) envisages using outsourcing; or
  - (c) requests exemption from compliance in accordance with Article 20.
5. The decision adopted by ESMA pursuant to paragraph 3 shall take effect on the fifth working day following its adoption.

## *Article 7*

### **Decision to grant or to refuse the authorisation to provide ESG ratings and notification of that decision**

1. ESMA shall authorise the applicant as ESG rating provider where it concludes from the examination of the application referred to in Article 6 that the applicant complies with the conditions for the provision of ratings set out in this Regulation.
2. ESMA shall inform the applicant within five working days of that decision referred to in the first paragraph.
3. ESMA shall inform the Commission, the EBA and EIOPA of any decision taken pursuant to paragraph 2.
4. The authorisation shall be effective for the entire territory of the Union.

## *Article 8*

### **Withdrawal or suspension of authorisation**

1. ESMA shall withdraw or suspend the authorisation of an ESG rating provider in any of the following cases:
  - (a) the ESG rating provider has expressly renounced the authorisation or has provided no ESG ratings for nine months preceding that withdrawal or suspension;
  - (b) the ESG rating provider has obtained its authorisation by making false statements or by any other irregular means;
  - (c) the ESG rating provider no longer meets the conditions under which it was authorised;

- (d) the ESG rating provider has seriously or repeatedly infringed this Regulation.
2. The decision on the withdrawal or suspension of authorisation shall take immediate effect throughout the Union.

## CHAPTER 2

### **Provision of ESG ratings in the Union by third country ESG rating providers**

#### *Article 9*

##### **Equivalence decision**

1. A third country ESG rating provider that wishes to provide ESG ratings in the Union shall only be able to do so where it is included in the register referred to in Article 13 and provided that all of the following conditions have been complied with:
- (a) the third country ESG rating provider is a legal person, is authorised or registered as an ESG rating provider in the third country concerned, and is subject to supervision by that third country;
  - (b) the third country ESG rating provider has notified ESMA that it wishes to provide ESG ratings in the Union and has informed ESMA with the name of the competent authority responsible for its supervision in the third country;
  - (c) the Commission has adopted an equivalence decision pursuant to paragraph 2;
  - (d) the cooperation arrangements referred to in paragraph 4 are operational.
2. The Commission may adopt an implementing decision stating that the legal framework and supervisory practice of a third country ensures that:
- (a) ESG rating providers authorised or registered in that third country comply with binding requirements which are equivalent to the requirements under this Regulation,
  - (b) compliance with the binding requirements referred to in point (a) is subject to effective supervision and enforcement on an on-going basis in that third country.

For the purposes of point (a), the Commission shall take into account whether the legal framework and supervisory practice of a third country ensures compliance with the IOSCO recommendations for ESG Ratings published in November 2021.

Such implementing decision shall be adopted in accordance with the examination procedure referred to in Article 47.

3. The Commission may adopt a delegated act in accordance with Article 45 to specify the conditions referred to in points (a) and (b) of the first subparagraph. The Commission may subject the application of the implementing decision referred to in paragraph 2 to:
- (a) the effective fulfilment on an ongoing basis by that third country of any condition set out in that implementing decision that aims at ensuring equivalent supervisory and regulatory standards;
  - (b) the ability of ESMA to effectively exercise the monitoring responsibilities referred to in Article 33 of Regulation (EU) No 1095/2010.

4. ESMA shall establish cooperation arrangements with the competent authorities of third countries whose legal framework and supervisory practices have been recognised as equivalent in accordance with paragraph 2. Such arrangements shall specify all of the following:

- (a) the mechanism for exchanging information between ESMA and the competent authorities of third countries concerned, including access to all relevant information requested by ESMA regarding the ESG rating provider authorised or registered in that third country;
- (b) the mechanism for prompt notification to ESMA where a third country competent authority deems that the ESG rating provider authorised or registered in that third country and that is supervised by that third country competent authority is breaching the conditions of its authorisation or registration, or other national law in that third country;
- (c) the procedures concerning the coordination of supervisory activities, including on-site inspections.

#### *Article 10*

#### **Endorsement of ESG ratings provided by a third country ESG rating provider**

1. An ESG rating provider located in the Union and authorised in accordance with Article 7 may endorse ESG ratings provided by a third country ESG rating provider belonging to the same group, provided that all of the following conditions have been met:
  - (a) the ESG rating provider located in the Union has applied to ESMA for authorisation of such endorsement;
  - (b) the ESG rating provider located in the Union has verified and is able to demonstrate on an on-going basis to ESMA that the provision of the ESG rating to be endorsed fulfils requirements which are at least as stringent as the requirements of this Regulation;
  - (c) the ESG rating provider located in the Union has the necessary expertise to monitor the provision of ESG ratings by the third country ESG rating provider effectively, and to manage any associated risks;
  - (d) there is an objective reason why the third country ESG rating provider has to provide the ESG rating and why that ESG rating has to be endorsed for their use in the Union;
  - (e) the ESG rating provider located in the Union provides ESMA at its request with all the information necessary to enable ESMA to supervise the compliance by the third country ESG rating provider with this Regulation on an ongoing basis;
  - (f) where a third country ESG rating provider is subject to supervision, an appropriate cooperation arrangement is in place between ESMA and the competent authority of the third country where the ESG rating provider is located, to ensure an efficient exchange of information;

For the purposes of point (b) of the first subparagraph, ESMA may consider that compliance of the provision of the ESG rating to be endorsed with the IOSCO recommendations for ESG ratings is equivalent to compliance with the requirements of this Regulation.

2. An ESG rating provider that applies for endorsement as referred to in paragraph 1 shall provide ESMA with all information necessary to satisfy ESMA that, at the time of application, all the conditions referred to in that paragraph are fulfilled.
3. Within 90 working days of receipt of the application for endorsement referred to in paragraph 1, ESMA shall examine the application and decide either to authorise the endorsement or to refuse it. ESMA shall publicly notify the decision to endorse provided by a third country ESG rating provider.
4. An endorsed ESG rating shall be considered to be an ESG rating provided by the endorsing ESG rating provider. The endorsing provider shall not use the endorsement to avoid or circumvent the requirements of this Regulation.
5. An ESG rating provider that has endorsed an ESG rating provided by a third country ESG rating provider shall remain fully responsible for such an ESG rating and for compliance with the obligations under this Regulation.
6. Where ESMA has well-founded reasons to consider that the conditions laid down in paragraph 1 are no longer fulfilled, it shall have the power to require the endorsing ESG rating provider to cease the endorsement.

#### *Article 11*

##### **Recognition of third country ESG rating providers**

1. Until the Commission has adopted an equivalence decision as referred to in Article 9 or, where adopted, in the event that the equivalence decision is repealed, third country ESG rating providers with an annual net turnover on their ESG rating activities below EUR 12 million for three consecutive years may provide ESG ratings to regulated financial undertakings in the Union, provided that ESMA has recognised that third country ESG rating provider in accordance with this paragraphs XX and YY.
2. Third country ESG rating providers that wish to be recognised as referred to in paragraph 1 shall comply with the requirements established in this Regulation and apply for recognition to ESMA. ESG rating providers may fulfil that condition by applying the IOSCO recommendations on ESG ratings provided that such application is equivalent to compliance with the requirements established in this Regulation.

For the purposes of the first subparagraph, ESMA may take into account either an assessment by an independent external auditor or a certification of the competent authority of the third country where the third country ESG rating provider is located.

3. Third country ESG rating providers that wish to be recognised as referred to in paragraph 1 shall have a legal representative. That legal representative shall be a legal person located in the Union and expressly appointed by that third country ESG rating provider to act on behalf of that ESG rating provider with regard to that ESG rating provider's obligations under this Regulation and, in that respect, be accountable to ESMA.
4. The third country ESG rating provider shall provide ESMA, prior to the recognition referred to in paragraph 1, with the following information:

- (a) all information necessary to satisfy ESMA that that third country ESG rating provider has established all the necessary arrangements to meet the requirements referred to in paragraph 2;
- (b) the list of its actual or prospective ESG ratings which are intended for provision in the Union;
- (c) where applicable, the name and contact details of the competent authority in the third country responsible for its supervision.

ESMA shall verify that the conditions laid down in paragraphs 2 and 3 are fulfilled within 90 working days of receipt of the application referred to in the first subparagraph of this paragraph.

5. ESMA shall recognise the third country ESG rating provider as referred to in paragraph 1 provided that all of the following conditions are met:
  - (a) the third country ESG rating provider has complied with all the conditions laid down in paragraphs 2, 3 and 4
  - (b) where the third country ESG rating provider is subject to supervision, ESMA shall seek to put in place an appropriate cooperation arrangement with the relevant competent authority of the third country where the ESG rating provider is located, to ensure an efficient exchange of information;
6. No recognition shall be granted where the effective exercise by ESMA of its supervisory functions under this Regulation is either prevented by the laws, regulations or administrative provisions of the third country where the third country ESG rating provider is established, or, where applicable, by limitations in the supervisory and investigatory powers of that third country's competent authority.
7. ESMA shall impose fines, in accordance with Article 30, suspend or, where appropriate, withdraw the recognition referred to in paragraph 1 where it has well-founded reasons, based on documented evidence, to consider that the ESG rating provider:
  - (a) is acting, or has been acting, in a manner which is clearly prejudicial to the interests of users of its ESG ratings or to the orderly functioning of markets;
  - (b) has seriously infringed the applicable requirements set out in this Regulation;
  - (c) made false statements or used any other irregular means to obtain the recognition.
8. ESMA shall develop draft regulatory technical standards to determine the form and content of the application referred to in paragraph 2 and, in particular, the presentation of the information required in paragraph 4. ESMA shall submit them to the Commission.

Power is conferred on the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with the procedure laid down in Articles 10 to 14 of Regulation (EU) No 1095/2010.

## *Article 12*

### **Cooperation arrangements**

1. Any cooperation arrangement as referred to in Article 9(4), Article 10(1), point (f) and Article 11(5), point (b), shall be subject to guarantees of professional secrecy



which are at least equivalent to those set out in Article 44. The exchange of information performed under such cooperation arrangements shall be intended for the performance of the tasks of ESMA or the competent authorities.

2. With regard to transfer of personal data to a third country, ESMA shall apply Regulation (EU) 2018/1725 of the European Parliament and of the Council<sup>51</sup>.

### CHAPTER 3

#### **Register and accessibility of information**

##### *Article 13*

#### **Register of ESG rating providers and accessibility of information on the European Single Access Point (ESAP)**

1. ESMA shall establish and maintain a register that contains information on all of the following:
  - (a) the identities of the ESG rating providers authorised pursuant to Article 7;
  - (b) the identities of third country ESG rating providers that comply with the conditions laid down in Article 9 and the third country competent authorities responsible for the supervision of those third country ESG rating providers;
  - (c) the identities of the endorsing ESG rating provider and the endorsed third country ESG rating provider referred to in Article 10, and, where applicable, the third country competent authorities that are responsible for the supervision of the endorsed third country ESG rating provider;
  - (d) the identities of the third country ESG rating providers that have been recognised in accordance with Article 11, and, where applicable, the third country competent authorities responsible for the supervision of those third country ESG rating providers;
2. The register referred to in paragraph 1 shall be publicly accessible on the website of ESMA and shall be updated promptly, as necessary.
3. From 1 January 2028, when making public any information pursuant to Article 18(1) and 21(1), the ESG rating provider shall submit that information to the relevant collection body referred to in paragraph 6 of this Article at the same time for accessibility on ESAP established under Regulation (EU) XX/XXXX [ESAP Regulation] of the European Parliament and of the Council\*.
4. That information shall comply with all of the following requirements:
  - (a) the information shall be prepared in a data extractable format as defined in Article 2, point (3), of Regulation (EU) XX/XXXX [ESAP Regulation] or,

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<sup>51</sup> Regulation (EU) 2018/1725 of the European Parliament and of the Council of 23 October 2018 on the protection of natural persons with regard to the processing of personal data by the Union institutions, bodies, offices and agencies and on the free movement of such data, and repealing Regulation (EC) No 45/2001 and Decision No 1247/2002/EC (OJ L 295, 21.11.2018, p. 39).

where required under Union law, in a machine-readable format, as defined in Article 2, point (4), of Regulation (EU) XX/XXXX [ESAP Regulation];

- (b) the information shall be accompanied by the following metadata:
- (1) all the names of the ESG rating provider submitting the information;
  - (2) the legal entity identifier of the ESG rating provider as specified pursuant to Article 7(4) of Regulation (EU) XX/XXXX [ESAP Regulation];
  - (3) the size of the ESG rating provider as specified pursuant to Article 7(4) of Regulation (EU) XX/XXXX [ESAP Regulation];
  - (4) the type of information as classified pursuant to Article 7(4) of Regulation (EU) XX/XXXX [ESAP Regulation];
  - (5) metadata specifying whether the information includes personal data.
5. For the purposes of paragraph 1, point (b)(ii) the ESG rating provider shall acquire the legal entity identifier as specified pursuant to Article 7(4) of Regulation (EU) XX/XXXX [ESAP Regulation].
6. For the purposes of making accessible on ESAP the information referred to in paragraph 1, the collection body as defined in Article 2, point (2), of Regulation (EU) XX/XXXX [ESAP Regulation] shall be ESMA.
7. From 1 January 2028, the information referred to in paragraph 1 and in Articles 10(3), 33(1), 34 and 35 shall be made accessible on ESAP. For that purpose, the collection body as defined in Article 2, point (2), of that Regulation shall be ESMA. That information shall be prepared in a data extractable format as defined in Article 2, point (3), of Regulation (EU) XX/XXXX [ESAP Regulation], include the metadata as regards the names and, where available, the legal entity identifier of the ESG rating provider as specified pursuant to Article 7(4) of that Regulation, the type of information as classified pursuant to Article 7(4) of that Regulation and whether the information includes personal data.
8. For the purposes of ensuring an efficient collection and administration of data submitted in accordance with paragraph 3, ESMA shall develop draft implementing technical standards to specify:
- (a) any other metadata to accompany the information;
  - (b) the structuring of data in the information;
  - (c) for which information a machine-readable format is required and which machine-readable format is to be used.

Before developing the draft implementing technical standards, ESMA shall carry out a cost-benefit analysis. For the purposes of point (c), ESMA shall assess the advantages and disadvantages of different machine-readable formats and conduct appropriate field tests.

ESMA shall submit those draft implementing technical standards to the Commission.

Power is conferred on the Commission to adopt the implementing technical standards referred to in the first subparagraph in accordance with Article 15 of Regulation (EU) No 1095/2010.

9. If necessary, ESMA shall adopt guidelines for entities to ensure that the metadata submitted in accordance with paragraph 8, first subparagraph, point (a), is correct.

### TITLE III

# INTEGRITY AND RELIABILITY OF ESG RATING ACTIVITIES

## CHAPTER 1

### Organisational requirements, processes and documents concerning governance

#### *Article 14*

##### **General principles**

1. ESG rating providers shall ensure the independence of their rating activities, including from all political and economic influences or constraints.
2. ESG rating providers shall have in place rules and procedures that ensure that their ESG rating are provided and published or made available in accordance with this Regulation.
3. ESG rating providers shall employ systems, resources and procedures that are adequate and effective to comply with their obligations under this Regulation.
4. ESG rating providers shall adopt and implement written policies and procedures that ensure that their ESG ratings are based on a thorough analysis of all relevant information available to them.
5. ESG rating providers shall adopt and implement internal due diligence policies and procedures that ensure that their business interests do not impair the independence or accuracy of the assessment activities.
6. ESG rating providers shall adopt and implement sound administrative and accounting procedures, internal control mechanisms, and effective control and safeguard arrangements for information processing systems.
7. ESG rating providers shall use rating methodologies for the ESG ratings they provide that are rigorous, systematic, objective and capable of validation and shall apply those rating methodologies continuously.
8. ESG rating providers shall review the rating methodologies referred to in paragraph 6 on an on-going basis and at least annually.
9. ESG rating providers shall monitor and evaluate the adequacy and effectiveness of the systems, resources and procedures referred to in paragraph 2 at least annually and take appropriate measures to address any deficiencies.
10. ESG rating providers shall establish and maintain a permanent and effective oversight function to ensure oversight of all aspects of the provision of their ESG ratings.

ESG rating providers shall develop and maintain robust procedures regarding their oversight function.

11. ESG rating providers shall adopt, implement, and enforce measures to ensure that their ESG ratings are based on a thorough analysis of all the information that is available to them and that is relevant to their analysis in accordance with their rating methodologies. They shall adopt all necessary measures to ensure that the information they use in assigning ESG ratings is of sufficient quality and from reliable sources. ESG rating providers shall explicitly mention that their ESG ratings are their own opinion .

12. 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<sup>52</sup>.
13. ESG rating providers shall only make changes to their ESG ratings in accordance with their rating methodologies published pursuant to Article 21.

#### *Article 15*

##### **Separation of business and activities**

1. ESG rating providers shall not provide any of the following activities:
  - (a) consulting activities to investors or undertakings;
  - (b) the issuance and sale of credit ratings;
  - (c) the development of benchmarks;
  - (d) investment activities;
  - (e) audit activities;
  - (f) banking, insurance, or reinsurance activities.
2. ESG rating providers shall ensure that the provision of other services than those referred to in paragraph 1 does not create risks of conflicts of interest within its ESG rating activities.

#### *Article 16*

##### **Rating analysts, employees and other persons involved in the provision of ESG ratings**

1. ESG rating providers shall ensure that rating analysts, employees and any other natural person whose services are placed at its disposal or under its control and who are directly involved in the provision of ESG ratings, including analysts directly involved in the rating process and persons involved in the provision of scores, have the knowledge and experience that is necessary for the performance of the duties and tasks assigned.
2. ESG rating providers shall ensure that the persons referred to in paragraph 1 are not allowed to initiate or participate in negotiations regarding fees or payments with any rated entity or any person directly or indirectly linked to the rated entity by control.
3. The persons referred to in paragraph 1 shall not buy or sell any financial instrument issued, guaranteed, or otherwise supported by any rated entity other than holdings in diversified collective investment schemes, including managed funds, nor engage in any transaction in such financial instruments.

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<sup>52</sup> 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).

4. The persons referred to in paragraph 1 shall not participate in or otherwise influence the determination of an ESG rating of any rated entity where those persons:
  - (a) own financial instruments of the rated entity, other than holdings in diversified collective investment schemes;
  - (b) own financial instruments of any entity related to a rated entity, the ownership of which may cause or may be generally perceived as causing a conflict of interest, other than holdings in diversified collective investment schemes;
  - (c) have had a recent employment, business or other relationship with the rated entity that may cause or may be generally perceived as causing a conflict of interest.
5. ESG rating providers shall ensure that the persons referred to in paragraph 1:
  - (a) take all reasonable measures to protect property and records in possession of the ESG rating provider from fraud, theft or misuse, taking into account the nature, scale and complexity of the ESG rating provider's business and the nature and range of ESG rating activities;
  - (b) do not share confidential information that has been entrusted to the ESG rating provider with anyone who is not directly involved in the provision of ESG rating activities, including rating analysts and employees of any person directly or indirectly linked to the ESG rating provider by control, and any other natural person whose services are or have been placed at the disposal of, or are under the control of, any person directly or indirectly linked to the ESG rating provider by control;
  - (c) do not use or share confidential information for any other purpose than the provision of ESG rating activities, including for the trading of financial instruments.
6. Persons as referred to in paragraph 1 that consider that any other person as referred to in paragraph 1 has engaged in conduct that they consider to be illegal shall immediately inform the compliance function thereof. The ESG rating provider shall ensure that such reporting does not have any negative consequences for the person reporting.
7. Where a rating analyst terminates his or her employment with the ESG rating provider and joins a rated entity which he or she has been involved in rating, the ESG rating provider shall review the work of the rating analyst over one year preceding his or her departure.
8. Persons as referred to in paragraph 1 shall not take up a key management position within a rated entity which they have been involved in rating for six months after the provision of such rating.

#### *Article 17*

#### **Record-keeping requirements**

1. ESG rating providers shall record their ESG rating activities. Those records shall contain the information listed in Annex II.
2. ESG rating providers shall keep the information referred to in paragraph 1 for at least five years and in such a form that it is possible to replicate and fully understand the determination of an ESG rating.

## *Article 18*

### **Complaints-handling mechanism**

1. ESG rating providers shall have in place and publish on their website procedures for receiving, investigating and retaining records concerning complaints made.
2. The procedures referred to in paragraph 1 shall ensure that:
  - (a) the ESG rating provider makes publicly available the complaints-handling policy through which complaints may be submitted on:
    - (1) the sources of data used for a specific ESG rating;
    - (2) the way in which the rating methodology in relation to a specific ESG rating has been applied;
    - (3) whether a specific ESG rating is representative of the rated entity;
    - (4) a proposed change to the ESG rating determination process;
    - (5) other decisions in relation to the ESG rating;
  - (b) complaints are investigated in a timely and fair manner and that the outcome of the investigation is communicated to the complainant within a reasonable period of time, unless such communication would be contrary to objectives of public policy or to Regulation (EU) No 596/2014 of the European Parliament and of the Council<sup>53</sup>;
  - (c) the inquiry is conducted independently of any personnel that has been involved in the subject-matter of the complaint.

## *Article 19*

### **Outsourcing**

1. ESG rating providers shall not outsource important operational functions where such outsourcing would materially impair the quality of the ESG rating provider's internal control policies and procedures, or the ability of the European Supervisory and Markets Authority (ESMA) to supervise the ESG rating provider's compliance with its obligations under this Regulation.
2. ESG rating providers that outsource functions or any services or activities that are relevant for the provision of an ESG rating shall remain fully responsible for discharging all of the obligations under this Regulation.
3. ESG rating providers that outsource functions or any services or activities that are relevant for the provision of an ESG rating shall remain fully responsible for disclosing the information referred to in Annex II.

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<sup>53</sup> Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC (OJ L 173, 12.6.2014, p. 1).

## *Article 20*

### **Exemptions on governance requirements**

1. ESMA may exempt an ESG rating provider at its request from complying with some of the requirements laid down in Article 14 where that ESG rating provider is able to demonstrate that those requirements are not proportionate in view of the nature, scale and complexity of its business and the nature and range of the issuance of ESG ratings and provided that:
  - (a) the ESG rating provider is a small or medium-sized undertaking according to the criteria laid down in Article 3 of Directive 2013/34/EU;
  - (b) the ESG rating provider has implemented measures and procedures, and in particular internal control mechanisms, reporting arrangements and measures, that ensure the independence of rating analysts and persons approving ESG ratings and that ensure the effective compliance with this Regulation;
  - (c) the size of the ESG rating provider is not determined in such a way as to avoid compliance with the requirements of this Regulation by an ESG rating provider or a group of ESG rating providers.
2. In the case of a group of ESG rating providers, ESMA shall ensure that at least one of the ESG rating providers in the group is not exempted from the requirements laid down in this Regulation.

## CHAPTER 2

### **Transparency requirements**

## *Article 21*

### **Disclosure of the methodologies, models, and key rating assumptions used in ESG rating activities to the public**

1. ESG rating providers shall disclose on their website the methodologies, models and key rating assumptions they use in their ESG rating activities, including the information referred to in point 1 of Annex III.
2. ESMA shall develop draft regulatory technical standards to specify further the elements that are to be disclosed in accordance with paragraph 1.
3. ESMA shall submit those draft regulatory technical standards to the Commission by XX XXXX XXXX.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with the procedure laid down in Articles 10 to 14 of Regulation (EU) No 1095/2010.

## *Article 22*

### **Disclosures to subscribers of ESG ratings and rated entities**

1. ESG rating providers shall disclose, as a minimum, the information referred to in point 2 of Annex III to their subscribers and to the rated entities.
2. ESMA shall develop draft regulatory technical standards to specify further the elements that are to be disclosed in accordance with paragraph 1.

3. ESMA shall submit those draft regulatory technical standards to the Commission by XX XXXX XXXX.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with the procedure laid down in Articles 10 to 14 of Regulation (EU) No 1095/2010.

## CHAPTER 3

### **Independence and conflicts of interest**

#### *Article 23*

#### **Independence and avoidance of conflicts of interest**

1. ESG rating providers shall have in place robust governance arrangements, including a clear organisational structure with well-defined, transparent, and consistent roles and responsibilities for all persons involved in the provision of an ESG rating.
2. ESG rating providers shall take all necessary steps to ensure that any ESG rating provided is not affected by any existing or potential conflict of interest, or by any business relationship, either from the ESG rating provider itself or from their shareholders, managers, rating analysts, employees or any other natural person whose services are placed at the disposal or under the control of the ESG rating providers, or any person directly or indirectly linked to them by control.
3. Where there is a risk of a conflict of interest within an ESG rating provider due to the ownership structure, controlling interests, or activities of that ESG rating provider, of any entity owning or controlling the ESG rating provider, of an entity that is owned or controlled by the ESG rating provider, or of any the ESG rating provider's affiliates, ESMA may require the ESG rating provider to take measures to mitigate that risk. Such measures may include the establishment of an independent oversight function representing stakeholders, including users of the ESG ratings and contributors to such ratings, in a balanced manner.

Where a conflict of interest as referred to in the first subparagraph cannot be adequately managed, ESMA may require the ESG rating provider to cease the activities or relationships that create the conflict of interest, or may require the ESG rating provider to cease providing the ESG ratings.

4. ESG rating providers shall disclose to ESMA all existing or potential conflicts of interest, including conflicts of interest arising from the ownership or control of the ESG rating providers.
5. ESG rating providers shall establish and operate policies, procedures, and effective organisational arrangements for the identification, disclosure, prevention, management and mitigation of conflicts of interest. ESG rating providers shall regularly review and update those policies, procedures and arrangements. Those policies, procedures and arrangements shall specifically prevent, manage and mitigate conflicts of interest due to the ESG rating provider's ownership or control or due to other interests in the ESG rating provider's group, or conflicts of interest that are caused by other persons that exercise influence or control over the ESG rating provider in relation to determining the ESG rating.
6. ESG rating providers shall review their operations to identify potential conflicts of interests at least each year.



## *Article 24*

### **Management of potential conflicts of interests from employees**

1. ESG rating providers shall ensure that their employees and any other natural persons whose services are placed at their disposal or under their control and who are directly involved in the provision of an ESG rating:
  - (a) have the skills that are necessary for performing their tasks and duties and are subject to effective management and supervision;
  - (b) are not subject to undue influence or conflicts of interest;
  - (c) that the compensation and performance evaluation of those persons do not create conflicts of interest or otherwise impinge upon the integrity of the ESG rating determination process;
  - (d) do not have any interests or business connections that compromise the activities of the ESG rating provider;
  - (e) are prohibited from contributing to an ESG rating determination by way of engaging in bids, offers and trades on a personal basis or on behalf of market participants, except where such contribution is explicitly required as part of the ESG rating methodology and is subject to specific rules laid down therein;
  - (f) are subject to effective procedures to control the exchange of information with other employees involved in activities that may create a risk of conflicts of interest or with third parties, where that information may affect the ESG rating.
2. ESG rating providers shall establish specific internal control procedures to ensure the integrity and reliability of the employee or person determining the ESG rating, including internal sign-off by management before the dissemination of the ESG rating.

## *Article 25*

### **Fair, reasonable, transparent and non-discriminatory treatment of users of ESG ratings**

1. ESG rating providers shall take steps that are adequate to ensure that fees charged to clients are fair, reasonable, transparent, non-discriminatory and are based on costs.
2. For the purposes of paragraph 1, ESMA may require ESG rating providers to provide it with documented evidence, may take supervisory measures in accordance with Article 33, and may decide to impose fines in accordance with Article 34 where it finds that fees from ESG rating providers are not fair, reasonable, transparent, non-discriminatory and not based on actual costs.

## CHAPTER 4

### **Supervision by ESMA**

#### Section 1

### **General principles**

## *Article 26*

### **Non-interference with the content of ratings or methodologies**

In carrying out their duties under this Regulation, ESMA, the Commission or any public authorities of a Member State shall not interfere with the content of ESG ratings or methodologies.

#### *Article 27*

##### **ESMA**

1. In accordance with Article 16 of Regulation (EU) No 1095/2010, ESMA shall issue and update guidelines on the cooperation between ESMA and the competent authorities for the purposes of this Regulation, including the procedures and detailed conditions relating to the delegation of tasks.
2. In accordance with Article 16 of Regulation (EU) No 1095/2010, ESMA shall, in cooperation with the EBA and EIOPA, issue and update guidelines on the application of the endorsement regime referred to in Article 10 of this Regulation by XX XXXX XXXX.
3. ESMA shall publish an annual report on the application of this Regulation, including on supervisory measures taken and penalties imposed by ESMA under this Regulation, including fines and periodic penalty payments. That report shall contain, in particular, information on the evolution of ESG Ratings market and an assessment of the application of the third country regimes referred to in Articles 9, 10 and 11.

ESMA shall present the annual report referred to in the first subparagraph to the European Parliament, the Council and the Commission.

4. ESMA shall cooperate with the EBA and EIOPA in performing its tasks and shall consult the EBA and EIOPA before issuing and updating guidelines and submitting draft regulatory technical standards.

#### *Article 28*

##### **Competent authorities**

1. By XX XXXX XXXX, each Member State shall designate a competent authority for the purposes of this Regulation.
2. Competent authorities shall be adequately staffed, with regard to capacity and expertise, to be able to apply this Regulation.

#### *Article 29*

##### **Exercise of the powers referred to in Articles 30 to 32**

The powers conferred on ESMA or any official of or other person authorised by ESMA by Articles 30 to 32 shall not be used to require the disclosure of information or documents which are subject to legal privilege.

#### *Article 30*

##### **Requests for information**

1. ESMA may by simple request or by decision require ESG rating providers, persons involved in ESG rating activities, rated entities, third parties to whom the ESG rating providers have outsourced operational functions or activities, and persons otherwise closely and substantially related or connected to ESG rating providers or ESG rating

activities, to provide all information that it needs to carry out its duties under this Regulation.

2. When sending a simple request for information under paragraph 1, ESMA shall:
  - (a) refer to this Article as the legal basis for the request;
  - (b) state the purpose of the request;
  - (c) specify what information is required;
  - (d) set a time-limit within which the information is to be provided;
  - (e) inform the person from whom the information is requested that there is no obligation to provide the information but that any reply to the request for information must not be incorrect or misleading;
  - (f) indicate the fine provided for in Article 34, where the answers to questions asked are incorrect or misleading.
3. When requiring the supply of information under paragraph 1 by decision, ESMA shall:
  - (a) refer to this Article as the legal basis for the request;
  - (b) state the purpose of the request;
  - (c) specify what information is required;
  - (d) set a time-limit within which the information is to be provided;
  - (e) indicate the periodic penalty payments provided for in Article 35 where the production of the required information is incomplete;
  - (f) indicate the fine provided for in Article 34, where the answers to questions asked are incorrect or misleading;
  - (g) indicate the right to appeal the decision before the Board of Appeal and to have the decision reviewed by the Court of Justice of the European Union in accordance with Articles 60 and 61 of Regulation (EU) No 1095/2010.
4. The persons referred to in paragraph 1 or their representatives and, in the case of legal persons or of associations having no legal personality, the persons authorised to represent them by law or by their constitution, shall supply the information requested. Lawyers duly authorised to act may supply the information on behalf of their clients. Those clients shall remain fully responsible if the information supplied by the lawyers is incomplete, incorrect or misleading.
5. ESMA shall, without delay, send a copy of the simple request or of its decision to the competent authority of the Member State where the persons referred to in paragraph 1 who are concerned by the request for information are domiciled or established.

### *Article 31*

#### **General investigations**

1. In order to carry out its duties under this Regulation, ESMA may conduct all necessary investigations of persons referred to in Article 30(1). To that end, the officials of and other persons authorised by ESMA shall be empowered to:
  - (a) examine any records, data, procedures and any other material relevant to the execution of its tasks irrespective of the medium on which they are stored;

- (b) take or obtain certified copies of or extracts from such records, data, procedures and other material;
  - (c) summon and ask any person referred to in Article 30(1), or their representatives or staff for oral or written explanations on facts or documents related to the subject matter and purpose of the inspection and to record the answers;
  - (d) interview any other natural or legal person who consents to be interviewed for the purpose of collecting information relating to the subject matter of an investigation;
  - (e) request records of telephone and data traffic.
2. The officials of and other persons authorised by ESMA for the purposes of the investigations referred to in paragraph 1 shall exercise their powers upon production of a written authorisation specifying the subject matter and purpose of the investigation. That authorisation shall also indicate the periodic penalty payments provided for in Article 35(1) where the production of the required records, data, procedures or any other material, or the answers to questions asked of the persons referred to in Article are not provided or are incomplete, and the fines provided for in Article 34, where the answers to questions asked of the persons referred to in Article are incorrect or misleading.
  3. The persons referred to in Article 30(1) shall submit to investigations launched on the basis of a decision of ESMA. The decision shall specify the subject matter and purpose of the investigation, the periodic penalty payments provided for in Article 3, the legal remedies available under Regulation (EU) No 1095/2010 and the right to have the decision reviewed by the Court of Justice of the European Union.
  4. In good time before the investigation, ESMA shall inform the competent authority of the Member State where the investigation is to be carried out of the investigation and of the identity of the authorised persons. Officials of the competent authority concerned shall, upon the request of ESMA, assist those authorised persons in carrying out their duties. Officials of the competent authority concerned may also attend the investigations upon request.
  5. If a request for records of telephone or data traffic referred to in point (e) of paragraph 1 requires authorisation from a judicial authority according to national rules, such authorisation shall be applied for. Such authorisation may also be applied for as a precautionary measure.
  6. Where authorisation as referred to in paragraph 5 is applied for, the national judicial authority shall control that the decision of ESMA is authentic and that the coercive measures envisaged are neither arbitrary nor excessive having regard to the subject matter of the investigations. In its control of the proportionality of the coercive measures, the national judicial authority may ask ESMA for detailed explanations, in particular relating to the grounds ESMA has for suspecting that an infringement of this Regulation has taken place and the seriousness of the suspected infringement and the nature of the involvement of the person subject to the coercive measures. However, the national judicial authority shall not review the necessity for the investigation or demand that it be provided with the information on ESMA's file. The lawfulness of ESMA's decision shall be subject to review only by the Court of Justice of the European Union following the procedure set out in Regulation (EU) No 1095/2010.

## Article 32

### On-site inspections

1. In order to carry out its duties under this Regulation, ESMA may conduct all necessary on-site inspections at the business premises of the legal persons referred to in Article 30(1). Where the proper conduct and efficiency of the inspection so require, ESMA may carry out the on-site inspection without prior announcement.
2. The officials of and other persons authorised by ESMA to conduct an on-site inspection may enter any business premises and land of the legal persons subject to an investigation decision adopted by ESMA and shall have all the powers stipulated in Article 31(1). They shall also have the power to seal any business premises and books or records for the period of, and to the extent necessary for, the inspection.
3. The officials of and other persons authorised by ESMA to conduct an on-site inspection shall exercise their powers upon production of a written authorisation specifying the subject matter and purpose of the inspection, and the periodic penalty payments provided for in Article 31 where the persons concerned do not submit to the inspection. In good time before the inspection, ESMA shall give notice of the inspection to the competent authority of the Member State where it is to be conducted.
4. The persons referred to in Article 30(1) shall submit to on-site inspections ordered by decision of ESMA. The decision shall specify the subject matter and purpose of the inspection, specify the date on which it is to begin and indicate the periodic penalty payments provided for in Article 31, the legal remedies available under Regulation (EU) No 1095/2010 as well as the right to have the decision reviewed by the Court of Justice of the European Union. ESMA shall take such decisions after consulting the competent authority of the Member State where the inspection is to be conducted.
5. Officials of, as well as those authorised or appointed by, the competent authority of the Member State where the inspection is to be conducted shall, upon the request of ESMA, actively assist the officials of and other persons authorised by ESMA. To that end, they shall enjoy the powers set out in paragraph 2. Officials of the competent authority of the Member State concerned may also attend the on-site inspections upon request.
6. ESMA may also require competent authorities to carry out specific investigatory tasks and on-site inspections as provided for in this Article and in Article 31(1) on its behalf. To that end, competent authorities shall enjoy the same powers as ESMA as set out in this Article and in Article 31(1).
7. Where the officials of and other accompanying persons authorised by ESMA find that a person opposes an inspection ordered pursuant to this Article, the competent authority of the Member State concerned shall afford them the necessary assistance, requesting, where appropriate, the assistance of the police or of an equivalent enforcement authority, so as to enable them to conduct their on-site inspection.
8. If the on-site inspection provided for in paragraph 1 or the assistance provided for in paragraph 7 requires authorisation by a judicial authority according to national rules, such authorisation shall be applied for. Such authorisation may also be applied for as a precautionary measure.
9. Where authorisation as referred to in paragraph 8 is applied for, the national judicial authority shall control that the decision of ESMA is authentic and that the coercive

measures envisaged are neither arbitrary nor excessive having regard to the subject matter of the inspection. In its control of the proportionality of the coercive measures, the national judicial authority may ask ESMA for detailed explanations, in particular relating to the grounds ESMA has for suspecting that an infringement of this Regulation has taken place and the seriousness of the suspected infringement and the nature of the involvement of the person subject to the coercive measures. However, the national judicial authority shall not review the necessity for the inspection or demand to be provided with the information on ESMA's file. The lawfulness of ESMA's decision shall be subject to review only by the Court of Justice of the European Union following the procedure set out in Regulation (EU) No 1095/2010.

## Section 2

### **Administrative sanctions and other administrative measures**

#### *Article 33*

#### **Supervisory measures by ESMA**

1. Where ESMA finds that a ESG rating provider has not complied with its obligations under this Regulation, it shall take one or more of the following supervisory measures:
  - (a) withdraw the authorisation of the ESG rating provider;
  - (b) temporarily prohibit the ESG rating provider from providing ESG ratings, until the infringement has been brought to an end;
  - (c) suspend the use of the ESG ratings provided by the ESG rating provider, until the infringement has been brought to an end;
  - (d) require the ESG rating provider to bring the infringement to an end;
  - (e) impose fines pursuant to Article 34;
  - (f) issue public notices.
2. The supervisory measures referred to in paragraph 1 shall be effective, proportionate, and dissuasive.
3. When taking the supervisory measures referred to in paragraph 1, ESMA shall take into account the nature and seriousness of the infringement, having regard to the following criteria:
  - (a) the duration and frequency of the infringement;
  - (b) whether financial crime has been occasioned, facilitated or otherwise attributable to the infringement;
  - (c) whether the infringement has been committed intentionally or negligently;
  - (d) the degree of responsibility of the person responsible for the infringement;
  - (e) the financial strength of the ESG rating provider, as indicated by its total annual net turnover;
  - (f) the impact of the infringement on retail investors' interests;

- (g) the importance of the profits gained and losses avoided by the ESG rating provider or the losses for third parties derived from the infringement, insofar as such profits and losses can be determined;
  - (h) the level of cooperation of the ESG rating provider with ESMA, without prejudice to the need to ensure disgorgement of profits gained or losses avoided by that ESG rating provider;
  - (i) previous infringements by the ESG rating provider;
  - (j) measures taken after the infringement by the ESG rating provider to prevent its repetition.
4. ESMA shall notify any action taken pursuant to paragraph 1 to the person responsible for the infringement without undue delay. ESMA shall publish any such action on its website within 10 working days from the date when it was adopted.

The publication referred to in the first subparagraph shall contain all of the following:

- (a) a statement affirming the right of the ESG rating provider to appeal the decision;
- (b) where relevant, a statement affirming that an appeal has been lodged and specifying that such an appeal does not have suspensive effect;
- (c) a statement asserting that it is possible for ESMA to suspend the application of the contested decision in accordance with Article 60(3) of Regulation (EU) No 1095/2010.

#### *Article 34*

##### **Fines**

1. Where ESMA finds that an ESG rating provider, or, where applicable, its legal representative, has, intentionally or negligently, infringed this Regulation, it shall adopt a decision imposing a fine. The maximum amount of the fine shall be 10 % of the total annual net turnover of the ESG rating provider, calculated on the basis of the most recent available financial statements approved by the management body of the ESG rating provider.
2. Where the ESG ratings provider is a parent undertaking or a subsidiary of a parent undertaking which is required to prepare consolidated financial accounts pursuant to Directive 2013/34/EU, the relevant total annual net turnover shall be either the total annual net turnover, or the corresponding type of income in accordance with the relevant Union law in the area of accounting, according to the most recent available consolidated accounts approved by the management body of the ultimate parent undertaking.
3. When determining the level of a fine pursuant to paragraph 1, ESMA shall take into account the criteria set out in Article 33(3).
4. Notwithstanding paragraph 3, where the ESG rating provider has directly or indirectly benefited financially from the infringement, the amount of the fine shall be at least equal to that benefit.
5. Where an act or omission of a ESG rating provider constitutes more than one infringement to this Regulation, only the higher fine calculated in accordance with paragraph 2 and relating to one of those infringements shall apply.

## Article 35

### Periodic penalty payments

1. ESMA shall, by decision, impose periodic penalty payments to compel:
  - (a) an ESG ratings provider to put an end to an infringement in accordance with a decision taken pursuant to Article 33;
  - (b) the persons referred to in Article 30(1):
    - (1) to supply complete information which has been requested by a decision taken pursuant to Article 30;
    - (2) to submit to an investigation and in particular to produce complete records, data, procedures or any other material required and to complete and correct other information provided in an investigation launched by a decision taken pursuant to Article 30;
    - (3) to submit to an on-site inspection ordered by a decision taken pursuant to Article 32.
2. A periodic penalty payment shall be effective and proportionate. ESMA shall impose the periodic penalty payment on a daily basis until the ESG rating provider or person concerned complies with the relevant decision referred to in paragraph 1.
3. Notwithstanding paragraph 2, the amount of the periodic penalty payments shall be 3 % of the average daily turnover in the preceding business year, or, in the case of natural persons, 2 % of the average daily income in the preceding calendar year. It shall be calculated from the date stipulated in the decision imposing the periodic penalty payment.
4. A periodic penalty payment shall be imposed for a maximum period of six months following the notification of ESMA's decision. Following the end of that period, ESMA shall review the measure.

## Article 36

### Disclosure, nature, enforcement and allocation of fines and periodic penalty payments

1. ESMA shall disclose to the public every fine and every periodic penalty payment that it has imposed pursuant to Articles 34 and 35, unless such disclosure to the public would seriously jeopardise the Union financial markets or cause disproportionate damage to the parties involved. Such disclosure shall not contain personal data within the meaning of Regulation (EU) 2018/1725 of the European Parliament and of the Council<sup>54</sup>.
2. Fines and periodic penalty payments imposed pursuant to Articles 34 and 35 shall be of an administrative nature.

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<sup>54</sup> Regulation (EU) 2018/1725 of the European Parliament and of the Council of 23 October 2018 on the protection of natural persons with regard to the processing of personal data by the Union institutions, bodies, offices and agencies and on the free movement of such data, and repealing Regulation (EC) No 45/2001 and Decision No 1247/2002/EC (OJ L 295, 21.11.2018, p. 39).



3. Fines and periodic penalty payments imposed pursuant to Articles 34 and 35 shall be enforceable.

Enforcement of the fines and periodic payments shall be governed by the rules of procedure in force in the Member State or third country in which it is carried out.

4. The fines and periodic penalty payments shall be allocated to the general budget of the European Union.

### Section 3

#### **Procedures and review**

##### *Article 37*

#### **Procedural rules for taking supervisory measures and imposing fines**

1. Where ESMA finds that there are serious indications of a possible infringement of this Regulation, ESMA shall appoint an independent investigation officer within ESMA to investigate the matter. That appointed officer shall not be involved or have been directly or indirectly involved in the supervision of the ESG ratings to which the infringement relates and shall perform his or her functions independently from ESMA's Board of Supervisors.
2. The investigation officer referred to in paragraph 1 shall investigate the alleged infringements, take into account any comments submitted by the persons who are subject to the investigation, and shall submit a complete file with his or her findings to ESMA's Board of Supervisors.
3. The investigation officer shall have the power to request information in accordance with Article 30 and to conduct investigations and on-site inspections in accordance with Articles 31 and 32.
4. When carrying out his or her tasks, the investigation officer shall have access to all documents and information that have been gathered by ESMA in its supervisory activities.
5. The rights of defence of the persons subject to the investigation shall be fully respected during investigations under this Article.
6. Upon submission of the file with his or her findings to ESMA's Board of Supervisors, the investigation officer shall notify the persons who are subject to the investigation.
7. On the basis of the file containing the investigation officer's findings and, where requested by the persons concerned after having heard those persons in accordance with Article 38, the Board of Supervisors of ESMA shall assess whether one or more persons subject to the investigation have committed the infringements concerned and shall, where it comes to the conclusion that such infringements have been committed, take a supervisory measure as referred to in Article 33 and impose a fine in accordance with Article 34.
8. The investigation officer shall not participate in the deliberations of ESMA's Board of Supervisors or in any other way intervene in the decision-making process of ESMA's Board of Supervisors.
9. The Commission shall supplement this Regulation by adopting further rules of procedure for the exercise of ESMA's power to impose fines or periodic penalty

payments, including provisions on rights of defence, temporal provisions, and the collection of fines or periodic penalty payments, and by adopting detailed rules on the limitation periods for the imposition and enforcement of penalties.

The rules referred to in the first subparagraph shall be adopted by means of delegated acts in accordance with Article 45.

10. ESMA shall refer matters for criminal prosecution to the national authorities concerned where, in carrying out its tasks under this Regulation, it finds that there are serious indications of the possible existence of facts liable to constitute criminal offences. ESMA shall refrain from imposing fines or periodic penalty payments where a prior acquittal or conviction arising from an identical fact or facts which are substantially the same has already acquired the force of *res judicata* as the result of criminal proceedings under national law.

#### *Article 38*

##### **Hearing of the persons subject to investigations**

1. Before taking any decision pursuant to Article 33, 34 and 35, ESMA shall give the persons subject to the proceedings the opportunity to be heard on its findings. ESMA shall base its decisions only on findings on which the persons subject to the proceedings have had an opportunity to comment.

The first subparagraph shall not apply where urgent action pursuant to Article 33 is needed to prevent significant and imminent damage to the financial system. In such a case, ESMA may adopt an interim decision and shall give the persons concerned the opportunity to be heard as soon as possible after taking its decision.

2. The rights of defence of the persons subject to the proceedings shall be fully respected in the investigations. They shall be entitled to have access to ESMA's file, subject to the legitimate interest of other persons in the protection of their business secrets. The right of access to the file shall not extend to confidential information or ESMA's internal preparatory documents.

#### *Article 39*

##### **Review by the Court of Justice**

The Court of Justice shall have unlimited jurisdiction to review decisions whereby ESMA has imposed a fine or a periodic penalty payment. It may annul, reduce, or increase the fine or periodic penalty payment imposed.

#### Section 4

##### **Fees and delegation**

#### *Article 40*

##### **Supervisory fees**

1. ESMA shall charge fees to the ESG rating providers in accordance with the delegated act adopted pursuant to paragraph 2. Those fees shall fully cover ESMA's necessary expenditure relating to the supervision of ESG rating providers and the reimbursement of any costs that the competent authorities may incur carrying out

work pursuant to this Regulation, and in particular as a result of any delegation of tasks in accordance with Article 41.

2. The amount of an individual fee shall be proportionate to the annual net turnover of the ESG ratings provider concerned.

By XX XXXX XXXX, the Commission shall adopt delegated acts in accordance with Article 45 to supplement this Regulation by specifying the type of fees, the matters for which fees are due, the amount of the fees, the manner in which they are to be paid and, where applicable, the way in which ESMA is to reimburse competent authorities in respect of any costs that they may have incurred carrying out work pursuant to this Regulation, in particular as a result of any delegation of tasks as referred to in Article 41.

## CHAPTER 5

### Cooperation between ESMA and national competent authorities

#### *Article 41*

##### **Delegation of tasks by ESMA to competent authorities**

1. Where necessary for the proper performance of a supervisory task, ESMA may delegate specific supervisory tasks to the competent authority of a Member State in accordance with the guidelines issued by ESMA pursuant to Article 16 of Regulation (EU) No 1095/2010. Such specific supervisory tasks may, in particular, include the power to carry out requests for information in accordance with Article 30 and to conduct investigations and on-site inspections in accordance with Article 31 and Article 32.
2. Prior to the delegation of a task in accordance with paragraph 1, ESMA shall consult the relevant competent authority about:
  - (a) the scope of the task to be delegated;
  - (b) the timetable for the performance of the task;
  - (c) the transmission of necessary information by and to ESMA.
3. ESMA shall reimburse a competent authority for costs incurred as a result of carrying out delegated tasks in accordance with the delegated act adopted pursuant to Article 45.
4. ESMA shall review any delegation made in accordance with paragraph 1 at appropriate intervals. ESMA may revoke a delegation at any time.
5. A delegation of tasks shall not affect the responsibility of ESMA nor limit ESMA's ability to conduct and oversee the delegated activity. ESMA shall not delegate supervisory responsibilities, including authorisation decisions, final assessments and follow-up decisions concerning infringements.

#### *Article 42*

##### **Exchange of information**

ESMA and the competent authorities, shall, without undue delay, provide each other with the information required for carrying out their duties under this Regulation.

### *Article 43*

#### **Notifications and suspension requests by competent authorities**

1. A competent authority of a Member State that finds that acts infringing this Regulation are being, or have been, carried out on the territory of its own or of another Member State shall inform ESMA thereof. A competent authority that considers it appropriate for investigatory purposes may suggest to ESMA that it assesses the need to use the powers under Article 30 in relation to the ESG rating provider involved in those acts.
2. ESMA shall take appropriate action. ESMA shall inform the notifying competent authority of the outcome and, as far as possible, of any significant interim developments.
3. A notifying competent authority of a Member State that considers that an ESG rating provider that is listed in the register referred to in Article 13 and whose ESG ratings are used within the territory of that Member State has infringed this Regulation in such a way that the protection of investors or the stability of the financial system in that Member State are significantly impacted, may request ESMA to suspend the provision of ESG ratings by the ESG rating provider concerned. The notifying competent authority shall provide ESMA with full reasons for its request.
4. Where ESMA considers that the request referred to in paragraph 3 is not justified, it shall inform the notifying competent authority thereof in writing, setting out the reasons for its opinion. Where ESMA considers that the request is justified, it shall take the measures appropriate to resolve the issue.

### *Article 44*

#### **Professional secrecy**

1. The obligation of professional secrecy shall apply to ESMA, the competent authorities, and all persons who work or who have worked for ESMA, for the competent authorities or for any other person to whom ESMA has delegated tasks, including auditors and experts contracted by ESMA.
2. All the information exchanged under this Regulation between ESMA, the competent authorities, the EBA, EIOPA and the ESRB shall be considered confidential, except:
  - (a) where ESMA or the competent authority or another authority or body concerned states at the time of communication that such information may be disclosed;
  - (b) where disclosure is necessary for legal proceedings;
  - (c) where the information disclosed is used in a summary or in an aggregate form in which individual financial market participants cannot be identified.

### TITLE IV

#### **DELEGATED AND IMPLEMENTING ACTS**

### *Article 45*

#### **Exercise and revocation of the delegation and objections to delegated acts**

1. The power to adopt delegated acts is conferred on the Commission subject to the conditions laid down in this Article.
2. The power to adopt delegated acts referred to in Articles 5, 21, 22 and 40 shall be conferred on the Commission for an indeterminate period of time from [*PO: Please insert date of entry into force*].
3. The delegation of power referred to in Articles 5, 21, 22 and 40 may be revoked at any time by the European Parliament or by the Council. A decision to revoke shall put an end to the delegation of the power specified in that decision. It shall take effect the day following the publication of the decision in the *Official Journal of the European Union* or at a later date specified therein. It shall not affect the validity of any delegated acts already in force.
4. Before adopting a delegated act, the Commission shall consult experts designated by each Member State in accordance with the principles laid down in the Inter-institutional Agreement of 13 April 2016 on Better Law-Making.
5. As soon as it adopts a delegated act, the Commission shall notify it simultaneously to the European Parliament and to the Council.
6. A delegated act adopted pursuant to Articles 7, 33, 34 and 40 shall enter into force only if no objection has been expressed either by the European Parliament or by the Council within a period of two months of notification of that act to the European Parliament and the Council or if, before the expiry of that period, the European Parliament and the Council have both informed the Commission that they will not object. That period shall be extended by [two months] at the initiative of the European Parliament or of the Council.
7. If, on expiry of the period referred to in paragraph 6, neither the European Parliament nor the Council has objected to the delegated act, it shall be published in the Official Journal of the European Union and shall enter into force on the date stated therein. The delegated act may be published in the Official Journal of the European Union and enter into force before the expiry of that period if the European Parliament and the Council have both informed the Commission of their intention not to raise objections.
8. If either the European Parliament or the Council objects to the delegated act within the period referred to in paragraph 1, it shall not enter into force. In accordance with Article 296 of the Treaty on the Functioning of the European Union, the institution which objects shall state the reasons for objecting to the delegated act.

#### *Article 46*

#### **Amendments to Annexes**

To take account of developments, including international developments, on financial markets, in particular in relation to sustainable finance, the Commission may adopt, by means of delegated acts in accordance with Article 45, measures to amend the Annexes.

#### *Article 47*

##### **Committee procedure**

1. The Commission shall be assisted by the European Securities Committee established by Commission Decision 2001/528/EC<sup>55</sup>. That committee shall be a committee within the meaning of Regulation (EU) No 182/2011 of the European Parliament and of the Council.<sup>56</sup>
2. Where reference is made to this paragraph, Article 5 of Regulation (EU) No 182/2011 shall apply.

#### TITLE V

##### **TRANSITIONAL AND FINAL PROVISIONS**

#### *Article 48*

##### **Transitional provisions**

1. ESG rating providers which provided their services at the date of entry into force of this Regulation shall notify ESMA within 3 months if they want to continue offering their services and apply for authorisation in accordance with Article 5. In that case, they shall apply for authorisation within 6 months after the date of application of this Regulation.
2. By way of derogation of the first paragraph, ESG rating providers categorized as small and medium-sized undertaking under Article 3 of the Directive 2013/34/EU shall apply for authorisation within 24 months after the date of application of this Regulation.
3. ESG rating providers categorized as small and medium-sized undertaking under Article 3 of Directive 2013/34/EU entering the market after [*please insert the date of entry into application*] shall notify ESMA prior to starting offering their services and shall apply for authorisation within 12 months of that notification.

#### *Article 49*

##### **Review**

1. The Commission shall evaluate the application of this Regulation by [*five years after the entry into force of this Regulation*].
2. The Commission shall present a report on the main findings of the evaluation to the European Parliament and the Council. In carrying out the evaluation, the

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<sup>55</sup> Commission Decision of 6 June 2001 establishing the European Securities Committee (OJ L 191, 13.7.2001, p. 45)

<sup>56</sup> Regulation (EU) No 182/2011 of the European Parliament and of the Council of 16 February 2011 laying down the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers (OJ L 55, 28.2.2011, p. 13).

Commission shall take into account market developments and the relevant evidence at its disposal.

3. Where the Commission finds it appropriate, the report shall be accompanied by a legislative proposal for amendment of relevant provisions of this Regulation.

*Article 50*

**Entry into force and application**

This Regulation shall enter into force on the 20<sup>th</sup> day following that of its publication in the *Official Journal of the European Union*.

It shall apply from [*6 months after the entry into force of this Regulation*].

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the European Parliament*

*The President*

*For the Council*

*The President*

**LEGISLATIVE FINANCIAL STATEMENT**



- 1. FRAMEWORK OF THE PROPOSAL/INITIATIVE**
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## 1. FRAMEWORK OF THE PROPOSAL/INITIATIVE

### 1.1. Title of the proposal/initiative

Proposal for a Regulation [of the European Parliament and of the Council] on transparency and operations of Environmental, Social and Governance (ESG) Rating providers.

### 1.2. Policy area(s) concerned

Policy area: Financial stability, financial services and capital markets union

### 1.3. The proposal relates to

a new action

a new action following a pilot project/preparatory action<sup>57</sup>

the extension of an existing action

a merger of one or more actions towards another/a new action

### 1.4. Objective(s)

#### 1.4.1. General objective(s)

The general objective of this initiative is to better exploit the potential of the European Single Market and to contribute to the transition towards a fully sustainable and inclusive economic and financial system in accordance with the European Green Deal and UN Sustainable Development Goals. This can be achieved by improving the ability of investors to make informed decisions regarding the sustainability of investments as well as by helping companies to understand their sustainability performance.

Since ESG ratings and underlying data are used for investment decisions and allocation of capital, the objective of the initiative is – by regulating ESG rating providers - to improve the quality and transparency of ESG ratings as to enable investors and rated companies to take better informed decisions with regard to managing ESG risks and the impacts of their investments or operations. At the same time, it is crucial to foster trust and confidence in the operations of ESG rating providers by ensuring that the market operates properly and ESG rating providers prevent and manage conflicts of interest.

#### 1.4.2. Specific objective(s)

There are two specific objectives, which relate to the two problem drivers:

- Increased clarity on ESG ratings characteristics (what they mean and what objectives they pursue), the methodologies and the data sources or estimates used to obtain the ESG ratings.

- Provide increased clarity on the operations of ESG rating providers as well as ensure the prevention and mitigation of risks of conflicts of interest at ESG rating providers' level.

#### 1.4.3. Expected result(s) and impact

*Specify the effects which the proposal/initiative should have on the beneficiaries/groups targeted.*

<sup>57</sup>

As referred to in Article 58(2)(a) or (b) of the Financial Regulation.

This Proposal should bring transparency and clarity to the operations of ESG rating providers. This should be beneficial for the users of those ratings but also rated companies and other interested stakeholders. It will contribute to the objectives of the EU Green Deal and sustainable finance strategy.

The Proposal will have significant direct and indirect economic impacts on the relevant parties. First, ESG rating providers will be subject to disclosure and other operational requirements, implying costs. Then, ESG rating users and rated entities will benefit from more transparency on ESG rating characteristics and operations of ESG rating providers. Public authorities (ESMA) will also be impacted, in particular with the introduction of supervision of ESG rating providers, even if within their existing structure

#### 1.4.4. *Indicators of performance*

*Specify the indicators for monitoring progress and achievements.*

The following indicators of performance have been identified:

##### Objective No 1

- the number of ESG ratings made available;
- the number of ESG ratings having financial risks and/or impact objectives;
- information made available to the public, online, by ESG rating providers, in particular development of eventual booklets/information papers;
- the extent to which ESG ratings/scores that measure the same constructs vary between different rating agencies, and in particular whether divergence declines over time;
- whether correlation of ESG ratings with similar objectives has increased.

##### Objective No 2

- the growth in use of ESG ratings by users and issuers;
- amount and market share of ESG investment based on ESG ratings;
- the number of scandals linked to ESG ratings.

### 1.5. **Grounds for the proposal/initiative**

#### 1.5.1. *Requirement(s) to be met in the short or long term including a detailed timeline for roll-out of the implementation of the initiative*

This proposal is an integral part of the European Commission's renewed sustainable finance strategy adopted in July 2021. Environmental, social, and governance (ESG) ratings play an enabling role for the proper functioning of the EU sustainable finance market by providing critical sources of information for investment strategies, risk management and disclosure obligations by investors and financial institutions. They are also used by companies who seek to better understand sustainability risks and opportunities linked to their activities or those of their partners, and how they compare to their peers on these issues.

This proposal aims to better exploit the potential of the European Single Market and the Capital Markets Union and to contribute to the transition towards a fully sustainable and inclusive economic and financial system in accordance with the European Green Deal and UN Sustainable Development Goals.

The current ESG rating market suffers from deficiencies and is not functioning properly, with users' and rated entities' needs regarding ESG ratings not being met and confidence in ratings undermined. This problem has a number of different dimensions, mainly (i) the lack of transparency on the characteristics of ESG ratings, their methodologies and their

data sources and (ii) the lack of clarity on how ESG rating providers operate. Therefore, ESG ratings do not serve their purpose and do not sufficiently enable users, investors and rated entities to take informed decisions as regards ESG-related risks, impacts and opportunities.

- 1.5.2. *Added value of Union involvement (it may result from different factors, e.g. coordination gains, legal certainty, greater effectiveness or complementarities). For the purposes of this point 'added value of Union involvement' is the value resulting from Union intervention which is additional to the value that would have been otherwise created by Member States alone.*

There is currently no EU regulatory framework for ESG rating providers. Member States do not regulate the activities of ESG rating providers or the conditions under which they deliver their products or services.

The objective of this initiative, to improve clarity over the characteristics of ESG ratings but also operations of ESG rating providers, cannot be sufficiently achieved by Member States acting independently. Action at EU level is necessary for the proper functioning of EU capital markets and to contribute to the transition towards a fully sustainable and inclusive economic and financial system in accordance with the European Green Deal and UN Sustainable Development Goals.

As attention to sustainable investing and ESG ratings grows in jurisdictions around the world, it is important for the EU to engage with its partners on the basis of a coherent and comprehensive European approach.

Although Member States could individually take action to strengthen the reliability and comparability of ESG ratings, such measures are likely to be significantly different between Member States, which may create diverging levels of transparency, barriers for market participants and challenges for those operating across borders (as this is particularly the case for this market, with users in a number of Member States), in addition to limiting comparability between ratings. This would cause issues and confusion for rated companies and rating users alike and could ultimately lead to an uneven protection of investors in different Member States.

- 1.5.3. *Lessons learned from similar experiences in the past*

Based on the experience with the supervision of CRAs, and on the fact that currently ESG ratings are not as systemically important as credit ratings they will therefore require a lower level of supervisory intensity to that which ESMA currently employs for CRAs. Therefore, compared with the supervisory costs for CRAs, the number of FTEs has been reduced by more than 50%, on the assumption that ESG rating providers require a lower level of supervisory intensity to that which ESMA currently employs for CRAs.

However, the role of ESG ratings in the financial ecosystem and their use for the regulatory purposes is likely to grow in the near future, thus the intensity of the supervisory tasks is likely to grow, too.

As per comparison with CRAs – there are currently 29 CRAs registered or certified by ESMA, whereas there are 59 ESG rating providers operating in the EU.

From existing experience of registration of CRAs, it is currently estimated that it would take 0.5 FTE six months to register one entity, no matter their size. Experience also shows that it is unlikely that the registration of an entity could be completed faster than within 6 months.

Lessons learned from regulating new markets/new providers (like CRAs or Benchmark Administrators), indicate that main effort in first year(s) is to authorise/register existing

entities, however, from the second year on, in addition to registration/authorisation, staff is needed to supervise entities authorised/registered in the previous years.

By way of comparison, ESMA has 37 TAs and 14 CAs (51 total) budgeted under credit rating agencies sub-activity for 2023. This includes core staff and centralised services. ESMA was given the task of the direct supervision of CRAs in 2011. The lessons learned during last 12 years demonstrate that the direct supervision of entities requires experienced staff that is employed on the permanent basis, therefore in the case of the supervision of CRAs, the number of TA is much higher than the number of CA.

*1.5.4. Compatibility with the Multiannual Financial Framework and possible synergies with other appropriate instruments*

The Commission is committed to achieving a green transition of the EU economy, as set out in the European Green Deal communication of December 2019 and the Strategy for Financing the Transition to a Sustainable Economy.

The ESG ratings proposal will contribute to this agenda by improving transparency over the operations of an important type of financial market participant that will also help channel private investments in sustainable projects and activities.

This legislative proposal is compatible with the Multiannual Financial Framework.

*1.5.5. Assessment of the different available financing options, including scope for redeployment*

ESMA would be tasked with granting authorisations and with supervising the sector on an ongoing basis, which would require further resources. The total annual cost increase is estimated at approximately EUR 3.7-3.8 million. This cost will not be borne by EU budget, as the proposal will include a provision that ESMA is enabled to charge authorisation and supervisory fees on ESG rating providers<sup>58</sup>, so as to cover all supervisory costs. This is similar to other areas, where ESMA is responsible for the oversight of certain entities (e.g. credit rating agencies).

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<sup>58</sup> Relative size of the fees depending on the size of ESG rating providers. Passing costs of supervision onto supervised entities is a typical practice in the financial sector.

**1.6. Duration and financial impact of the proposal/initiative**

**limited duration**

- Proposal/initiative in effect from [DD/MM]YYYY to [DD/MM]YYYY
- Financial impact from YYYY to YYYY

**unlimited duration**

- Implementation with a start-up period from 2022 to 2024,
- followed by full-scale operation.

**1.7. Management mode(s) planned<sup>59</sup>**

**Direct management** by the Commission through

- executive agencies

**Shared management** with the Member States

**Indirect management** by entrusting budget implementation tasks to:

international organisations and their agencies (to be specified);

the EIB and the European Investment Fund;

bodies referred to in Articles 70 and 71;

public law bodies;

bodies governed by private law with a public service mission to the extent that they provide adequate financial guarantees;

bodies governed by the private law of a Member State that are entrusted with the implementation of a public-private partnership and that provide adequate financial guarantees;

persons entrusted with the implementation of specific actions in the CFSP pursuant to Title V of the TEU, and identified in the relevant basic act.

Comments

N/A

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<sup>59</sup> Details of management modes and references to the Financial Regulation may be found on the BudgWeb site: <https://myintracomm.ec.europa.eu/budgweb/EN/man/budgmanag/Pages/budgmanag.aspx>.

## 2. MANAGEMENT MEASURES

### 2.1. Monitoring and reporting rules

*Specify frequency and conditions.*

In line with already existing arrangements, the ESAs prepare regular reports on their activity (including internal reporting to Senior Management, reporting to Boards and the production of the annual report), and are subject to audits by the Court of Auditors and the Commission's Internal Audit Service on their use of resources and performance. Monitoring and reporting of the actions included in the proposal will comply with the already existing requirements, as well as with any new requirements resulting from this proposal.

### 2.2. Management and control system(s)

#### 2.2.1. *Justification of the management mode(s), the funding implementation mechanism(s), the payment modalities and the control strategy proposed*

Management will be indirect through the ESAs. The funding mechanism would be implemented through authorisation and supervisory fees levied by ESMA on ESG rating providers.

#### 2.2.2. *Information concerning the risks identified and the internal control system(s) set up to mitigate them*

In relation to the legal, economic, efficient and effective use of appropriations resulting from the proposal, it is expected that the proposal would not bring new significant risks that would not be covered by an existing internal control framework. However, a new challenge might be related to ensuring timely collection of fees from the ESG rating providers.

#### 2.2.3. *Estimation and justification of the cost-effectiveness of the controls (ratio of "control costs ÷ value of the related funds managed"), and assessment of the expected levels of risk of error (at payment & at closure)*

Management and control systems as provided for in the ESAs Regulations are already implemented. ESAs work closely together with the Internal Audit Service of the Commission to ensure that the appropriate standards are met in all areas of internal control framework. These arrangements will apply also with regard to the role of the ESAs according to the present proposal. In addition, every financial year, the European Parliament, following a recommendation from the Council, grants discharge to each ESA for the implementation of their budget.



### 2.3. Measures to prevent fraud and irregularities

*Specify existing or envisaged prevention and protection measures, e.g. from the Anti-Fraud Strategy.*

For the purpose of combating fraud, corruption and any other illegal activity, the provisions of Regulation (EU, Euratom) N°883/2013 of the European Parliament and of the Council of 11 September 2013 concerning investigations conducted by the European Anti-Fraud Office (OLAF) apply to the ESAs without any restriction. The ESAs have a dedicated anti-fraud strategy and resulting action plan. The ESAs' strengthened actions in the area of anti-fraud will be compliant with the rules and guidance provided by the Financial Regulation (anti-fraud measures as part of sound financial management), OLAF's fraud prevention policies, the provisions provided by the Commission Anti-Fraud Strategy (COM(2011)376) as well as set out by the Common Approach on EU decentralised agencies (July 2012) and the related roadmap. In addition, the Regulations establishing the ESAs as well as the ESAs' Financial Regulations set out the provisions on implementation and control of the ESAs' budgets and applicable financial rules, including those aimed at preventing fraud and irregularities.

## 3. ESTIMATED FINANCIAL IMPACT OF THE PROPOSAL/INITIATIVE

### 3.1. Heading(s) of the multiannual financial framework and expenditure budget line(s) affected

- Existing budget lines

In order of multiannual financial framework headings and budget lines.

Heading of multiannual financial framework	Budget line	Type of expenditure	Contribution			
	Number	Diff./Non-diff. <sup>60</sup>	from EFTA countries <sup>61</sup>	from candidate countries <sup>62</sup>	from third countries	within the meaning of Article 21(2)(b) of the Financial Regulation
	N/A	Diff.	NO	NO	NO	NO

- New budget lines requested

In order of multiannual financial framework headings and budget lines.

Heading of multiannual financial framework	Budget line	Type of expenditure	Contribution			
	Number	Diff./non-diff.	from EFTA countries	from candidate countries	from third countries	within the meaning of Article 21(2)(b) of the Financial Regulation
	N/A					

<sup>60</sup> Diff. = Differentiated appropriations / Non-diff. = Non-differentiated appropriations.

<sup>61</sup> EFTA: European Free Trade Association.

<sup>62</sup> Candidate countries and, where applicable, potential candidates from the Western Balkans.

### 3.2. Estimated impact on expenditure

#### 3.2.1. Summary of estimated impact on expenditure

EUR million (to three decimal places)

<b>Heading of multiannual financial framework</b>	Number	[Heading.....]
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[Body]: <.....>			2023	2024	2025	2026	2027	TOTAL
Title 1:	Commitments	(1)						
	Payments	(2)						
Title 2:	Commitments	(1a)						
	Payments	(2a)						
Title 3:	Commitments	(3a)						
	Payments	(3b)						
<b>TOTAL appropriations for [body] &lt;.....&gt;</b>	Commitments	=1+1a +3a						
	Payments	=2+2a +3b						

<b>Heading of multiannual financial framework</b>	<b>7</b>	‘Administrative expenditure’
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EUR million (to three decimal places)

2023	2024	2025	2026	2027	<b>TOTAL</b>
------	------	------	------	------	--------------

DG: <.....>						
• Human Resources						
• Other administrative expenditure						
<b>TOTAL DG &lt;.....&gt;</b>	Appropriations					

<b>TOTAL appropriations under HEADING 7 of the multiannual financial framework</b>	(Total commitments = Total payments)						
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EUR million (to three decimal places)

2023	2024	2025	2026	2027	<b>TOTAL</b>
------	------	------	------	------	--------------

<b>TOTAL appropriations under HEADINGS 1 to 7 of the multiannual financial framework</b>	Commitments					
	Payments					

3.2.2. *Estimated impact on ESMA's appropriations*

- The proposal/initiative does not require the use of operational appropriations
- The proposal/initiative requires the use of operational appropriations, as explained below:

Commitment appropriations in EUR million (to three decimal places)

Indicate objectives and outputs ↓			2023		2024		2025		2026		2027		TOTAL	
	<b>OUTPUTS</b>													
	Type <sup>63</sup>	Average cost	No	Cost	No	Cost	No	Cost	No	Cost	No	Cost	Total No	Total cost
SPECIFIC OBJECTIVE No 1: On-boarding entities to supervisory reporting system														
- Output	Entities on-boarded						40	0.035	10	0.005	9	0.005	59	0.045
Subtotal for specific objective No 1							40	0.035	10	0.005	9	0.005	59	0.045
SPECIFIC OBJECTIVE No 2														
- Output														
- Output														

<sup>63</sup> Outputs are products and services to be supplied (e.g.: number of student exchanges financed, number of km of roads built, etc.).

Subtotal for specific objective No 2												
<b>TOTAL COST</b>					40	0.035	10	0.005	9	0.005	59	0.045

### 3.2.3. Estimated impact on ESMA's human resources

#### 3.2.3.1. Summary

- The proposal/initiative does not require the use of appropriations of an administrative nature
- The proposal/initiative requires the use of appropriations of an administrative nature, as explained below:

EUR million (to three decimal places)

	2023	2024	2025	2026	2027	TOTAL
--	------	------	------	------	------	-------

Temporary agents (AD Grades)			0.587	1.198	1.222	<b>3.006</b>
Temporary agents (AST grades)			0.098	0.200	0.203	<b>0.501</b>
Contract staff			0.918	1.873	1.720	<b>4.512</b>
Seconded National Experts						

<b>TOTAL<sup>64</sup></b>			<b>1.603</b>	<b>3.271</b>	<b>3.145</b>	<b>8.020</b>
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Staff requirements (FTE):

	2023	2024	2025	2026	2027	TOTAL
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Temporary agents (AD Grades)			6	6	6	<b>18</b>
Temporary agents (AST grades)			1	1	1	<b>3</b>
Contract staff			12	12	10	<b>34</b>
Seconded National Experts						

<b>TOTAL</b>			<b>19</b>	<b>19</b>	<b>17</b>	
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<sup>64</sup> All fee funded (including employer's pension contributions)



### 3.2.3.2. Estimated requirements of human resources for the parent DG

- The proposal/initiative does not require the use of human resources.
- The proposal/initiative requires the use of human resources, as explained below:

*Estimate to be expressed in full amounts (or at most to one decimal place)*

	Year N	Year N+1	Year N+2	Year N+3	Enter as many years as necessary to show the duration of the impact (see point 1.6)		
<b>• Establishment plan posts (officials and temporary staff)</b>							
20 01 02 01 and 20 01 02 02 (Headquarters and Commission's Representation Offices)							
20 01 02 03 (Delegations)							
01 01 01 01 (Indirect research)							
10 01 05 01 (Direct research)							
<b>• External staff (in Full Time Equivalent unit: FTE)<sup>65</sup></b>							
20 02 01 (AC, END, INT from the 'global envelope')							
20 02 03 (AC, AL, END, INT and JPD in the Delegations)							
Budget line(s) (specify) <sup>66</sup>	- at Headquarters <sup>67</sup>						
	- in Delegations						
<b>01 01 01 02</b> (AC, END, INT – Indirect research)							
10 01 05 02 (AC, END, INT – Direct research)							
Other budget lines (specify)							

<sup>65</sup> AC = Contract Staff; AL = Local Staff; END = Seconded National Expert; INT = agency staff; JPD = Junior Professionals in Delegations.

<sup>66</sup> Sub-ceiling for external staff covered by operational appropriations (former 'BA' lines).

<sup>67</sup> Mainly for the EU Cohesion Policy Funds, the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime Fisheries and Aquaculture Fund (EMFAF).



<b>TOTAL</b>							
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The human resources required will be met by staff from the DG who are already assigned to management of the action and/or have been redeployed within the DG, together if necessary with any additional allocation which may be granted to the managing DG under the annual allocation procedure and in the light of budgetary constraints.

Description of tasks to be carried out:

Officials and temporary staff	
External staff	

Description of the calculation of cost for FTE units should be included in the Annex V, section 3.

### 3.2.4. *Compatibility with the current multiannual financial framework*

- The proposal/initiative is compatible the current multiannual financial framework.
- The proposal/initiative will entail reprogramming of the relevant heading in the multiannual financial framework.

Explain what reprogramming is required, specifying the budget lines concerned and the corresponding amounts.  
N/A

- The proposal/initiative requires application of the flexibility instrument or revision of the multiannual financial framework<sup>68</sup>.

Explain what is required, specifying the headings and budget lines concerned and the corresponding amounts.  
N/A

### 3.2.5. *Third-party contributions*

- The proposal/initiative does not provide for co-financing by third parties.
- The proposal/initiative provides for the co-financing estimated below:

EUR million (to three decimal places)

	2023	2024	2025	2026	2027	<b>Total</b>
Estimate of costs covered by supervisory fees			1.911	3.833	3.685	9.430
<b>TOTAL appropriations co-financed (including employer's pension contributions)</b>			1.911	3.833	3.685	9.430

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<sup>68</sup> See Articles 12 and 13 of Council Regulation (EU, Euratom) No 2093/2020 of 17 December 2020 laying down the multiannual financial framework for the years 2021 to 2027.

### 3.3. Estimated impact on revenue

–  The proposal/initiative has no financial impact on revenue.

–  The proposal/initiative has the following financial impact:

–  on own resources

–  on other revenue

–  please indicate, if the revenue is assigned to expenditure lines

EUR million (to three decimal places)

Budget revenue line:	Appropriations available for the current financial year	Impact of the proposal/initiative <sup>69</sup>					Enter as many years as necessary to show the duration of the impact (see point 1.6)		
		Year N	Year N+1	Year N+2	Year N+3				
Article .....									

For miscellaneous 'assigned' revenue, specify the budget expenditure line(s) affected.

Specify the method for calculating the impact on revenue.

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<sup>69</sup> As regards traditional own resources (customs duties, sugar levies), the amounts indicated must be net amounts, i.e., gross amounts after deduction of 20 % for collection costs.

## Annex to the Legislative Financial Statement

### General Assumptions:

- Legislation enters into force in the second half of 2024.
- Direct supervision and fees will start 6 months later, in 2025.
- The cost of additional staff expenditure (Title I) has been calculated using the average staff costs applicable from January 2023 of EUR 171 000 per Temporary Agent and EUR 91 000 per Contract Agent (i.e., the standard costs excluding the standard EUR 29 000 ‘habillage’ cost for the building and IT costs associated with additional FTEs).

The currently applicable correction coefficient for Paris (118.7) was applied to these standard costs, which were then indexed at 2% for years after 2023 (as is standard practice when programming the Union budget taking into account that in some years inflation may be less and in others it may be more).

- The cost of additional infrastructure and operating expenditure (Title II) has been calculated using the standard EUR 29 000 ‘habillage’ allocation for the building and IT costs associated with additional FTEs, indexed at 2% for years after 2023. In addition, a standard cost of EUR 2 500 per FTE (also indexed at 2% for years after 2023) has been included for other administrative costs not covered by the allocation ‘habillage’

The forecast impact on the Union budget was estimated on the following basis:

### Title I – Staff Expenditure

- Calculations are based on the following data: there are 59 entities operating in the EU, out of which 30 are located in the EU, and 29 are located outside the EU. For the non-EU based entities there will be 3 ways in which they will be able to provide services in the EU: a) equivalence b) endorsement c) recognition. The intensity of supervisory tasks will vary depending on the location of providers (EU vs non-EU).

EU based entities: In the case of 30 ESG providers based in the EU (3 large + 6 medium + 9 small + 12 micro): i) in year (n), it will take 6 months for the authorisation of 30 entities based in EU (CAs)+ 6 months of supervision of those entities that have already been authorised (TAs). ii) in year (n)+1 supervision of 30 entities. iii) in year (n)+2, supervision of 30 entities.

- EU providers assumptions: COM estimates, on the basis of the input from ESMA, that it would take 1.7 FTE to supervise a large ESG rating provider and 0.2 FTE to supervise a small ESG rating provider. This is based on the assumption that ESG ratings are not as systemically important as credit ratings and will therefore require a lower level of supervisory intensity to that which ESMA currently employs for CRAs, COM has therefore applied a 50% reduction to FTE numbers for CRAs.
- Non-EU based ESG rating providers assumptions:

We considered for non-EU providers = 0.1 FTE (half of time allocated for an EU based micro ESG provider), considering 29 non-EU based ESG providers, we considered a flat fee of €3,000 per each ESG provider non-EU based (half of the amount of fees charged to certified CRAs €6,000).

- It is to be noted that the balance of staff under the ESG rating mandate (more CAs vs TAs) differs from the approach to CRAs. In both cases ESMA has a mandate of the direct supervision, however, in the case of CRAs it has considerably more TAs than CAs than TAs (37 TAs and 14 CAs) in order to ensure that skilled and experienced staff is employed on permanent basis.

- We consider it is likely there will be a peak of one-off work in the first year (year 2025) related to the authorisation. In this respect, it will be important that ESMA is given the above 19 FTEs from the start, to manage this peak. For the years 2027, it is likely the initial heavy workload of registration and authorisation will ease, and the number of temporary CAs could be reduced, so that the total number of FTEs can be reduced to 17. However, in the year 2027, ESMA will be responsible for the supervision of all entities registered and authorised in years 2025 and 2026, therefore the proposed reduction cannot be too substantial.
- Compared with number of FTEs for the direct supervision of CRAs the number of FTEs for the direct supervision of ESG rating providers has been reduced by more than 50% (total of 51 FTEs for CRAs vs 19 FTEs in 2025/2026 and 17 FTEs in 2027 for ESG rating providers). This is considered to be a minimum staff that can guarantee the proper direct supervision of the market of 59 entities.

#### Title III – operational expenditures

- Justification of 35.000 EUR for on-boarding of entities to supervisory reporting system. This cost is necessary to create a module in the system that ESMA uses for supervisory reporting called B Wise. Given the new mandate of direct supervision, the supervisory reporting system needs to be expanded. In addition to the initial costs, there will be a recurring annual maintenance fee of 5.000 EUR.
- The reporting system enables ESMA to process supervisory documentation received from entities, and helps reduce manual labour of opening and saving e-mail attachments manually. It therefore helps to reduce FTE costs.

**Estimated expenditure to be covered by fees for all direct supervisory tasks undertaken by ESMA**

EUR

ESMA			2023	2024	2025	2026	2027	TOTAL
Title 1: Staff expenditure	Commitments	(1)			1.603.618	3.271.382	3.145.675	<b>8.020.675</b>
	Payments	(2)			1.603.618	3.271.382	3.145.675	<b>8.020.675</b>
Title 2: Infrastructure and operating expenditure	Commitments	(1a)			273.105	557.134	534.849	<b>1.365.088</b>
	Payments	(2a)			273.105	557.134	534.849	<b>1.365.088</b>
Title 3: operational expenditure	Commitments	(3a)			35.000	5.000	5.000	<b>45.000</b>
	Payments	(3b)			35.000	5.000	5.000	<b>45.000</b>
<b>TOTAL appropriations</b>	Commitments	=1+1a +3a			<b>1.911.724</b>	<b>3.833.516</b>	<b>3.685.523</b>	<b>9.430.763</b>
	Payments	=2+2a +3b			<b>1.911.724</b>	<b>3.833.516</b>	<b>3.685.523</b>	<b>9.430.763</b>