



# New UK ESG Ratings Regulation

29 November 2024

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## Introduction

On 14 November 2024, HM Treasury published its [response document](#) and [draft Statutory Instrument](#) (Draft SI) confirming that providers of Environmental, Social and Governance (ESG) ratings will be brought within the scope of the UK regulatory perimeter.

ESG ratings providers will be required to be authorised by the UK Financial Conduct Authority (FCA) and comply with the regulatory regime, which will be prescribed and developed by the FCA in due course.

The yet to be published FCA rules are expected to cover matters such as transparency, good governance, conflict of interests and systems and controls (eg, covering policies, procedures and controls, issues of integrity, independence, engagement with rated entities and reporting of misconduct). The rules are expected to be influenced by and take account of the [International Organisation of Securities Commissions \(IOSCO\) 2021 recommendations](#). The rules that will ultimately apply to ESG ratings providers will be familiar to those who operate in the benchmark administration space.

The scope of the activity is broad both from a product and jurisdictional perspective and although similar to the proposed EU ESG Ratings Regulation, there are important differences.

## In scope ESG rating activity

### Activity in scope

Providing an ESG rating will be regulated, thereby triggering a requirement to be authorised by the FCA, where the rating is: (a) produced using an established methodology and a defined ranking system or rating categories (e.g., assigning a colour, number, symbol, letter, etc); (b) made available by a provider; and (c) likely to influence a decision to make a specified investment.

However, merely distributing an ESG rating (by itself and without any manipulation or alteration of the original rating) will not fall within the scope of the new regime.

### Key concepts

The Draft SI includes a number of useful definitions to assist firms and market participants in interpreting the scope of the new regime:

- **ESG opinion:** “an ESG rating involving substantial analytical input from an analyst, whether or not it is characterised as an ESG opinion.”
- **ESG rating:** “an assessment regarding one or more ESG factors, produced in the form of an ESG opinion, an ESG score or a combination of both, whether or not it is characterised as an ESG rating.”
- **ESG score:** “an ESG rating derived from data and a pre-established statistical or algorithmic system or model, without additional substantial analytical input from an analyst, whether or not it is characterised as an ESG score.”
- **Made available:** "includes, but is not limited to, providing to another person in hard-copy or electronic form or publishing on a website or other digital medium.”
- **Located in the UK:** "in relation to a legal person, they have a registered office or other official address in the UK and, in relation to a natural person, they are resident for tax purposes in the UK";
- **Rating Category:** "includes, but is not limited to, a variable or division within a system, such as letter, number, symbol, colour or temperature, which provides a relative measure to distinguish one or more characteristics of various rated items"; and
- **Specified Investment:** "means an investment of a kind specified in the [UK] Regulated Activities Order...". This will include shares, debt securities, units in funds, options, futures, and contracts for difference".

In addition, the HMT response document defines an "established methodology" as involving techniques and procedures systematically utilised to identify, collect, analyse, and interpret data in order to produce a rating.

### Products likely to fall within scope

The new regime is intended to capture:

- Both general ESG ratings products (eg, aggregate ESG ratings on corporate entities and funds) and specific ones (eg, biodiversity or controversy scores);
- A rating that is likely to be used to influence portfolio construction and asset allocation (but not in circumstances where the ESG rating provider could not reasonably have expected the rating to influence a decision to make a specified investment); and
- A pre-initial public offering rating - since these ratings can be reasonably expected to be likely to influence an investors decision to make a specified investment.

Interestingly, Investment research is not automatically outside of scope (although see the products and services exemption below) and it is unclear whether disclosures made to comply with ESG disclosure requirements (whether mandated in the UK or outside the UK) will also fall outside scope.

### Exclusions

The draft SI includes a number of exclusions including:

- **Intra-Group exclusion:** There is an exclusion for ESG ratings produced for the sole use of the firm and/or other entities within the same group. But it is important to note that this exclusion only applies if the ESG ratings provider reasonably expects that the rating will not be made available to

a third party outside the group. This will require controls around the use and distribution of such ratings.

- **Bespoke/private ratings exclusion:** This exclusion applies if an entity solicits an ESG rating of itself from an external ESG ratings provider and that rating is provided only to the soliciting party and/or a member of its group. As is the case for the intra-group exclusion, this exclusion will only apply if the ESG rating provider reasonably expects that the rating will not be made available to a third party outside the group of the soliciting firm.
- **Ancillary non-commercial provision exclusion:** This exclusion is intended to apply to ESG ratings produced as an integral part of journalistic, academic, or UK-registered charitable activity. However, the exclusion will not apply if the rating is provided on a business relationship basis separate to the person's activities as a journalist, an academic, or a charity.
- **Public authorities' exclusion:** This exclusion applies to public authorities, central banks, and international organisations.
- **The regulated products and services exclusion:** This exclusion is intended to exclude firms from the requirement to be authorised to provide ESG ratings where they create an ESG rating as part of the development and delivery of another regulated activity for which they are authorised provided that the ESG ratings are not provided as a standalone product or service. This exclusion is intended to apply to any product or service that is regulated by the FCA (e.g., funds, benchmarks, research, and credit ratings). However, it is important to note that even if a firm is not required to apply for a new permission, they may still need to comply with new FCA conduct of business rules relating to the provision of ESG ratings. Therefore, firms who incorporate ESG ratings into their products or services should review and engage with the upcoming FCA consultation which is expected to be published in early 2025.

Further exclusions may be included prior to the Draft SI being finalised including for ESG ratings that are provided as part of proxy advisory services, as opposed to a standalone product or service.

## Jurisdictional Scope and Presence

### Overview

The scope of the UK ESG ratings regime is intended to be broad and will capture:

- **UK firms** who provide ESG ratings to UK and non-UK users "by any means". In this regard, UK firms will fall in scope regardless of whether they provide the ESG rating by way of a business relationship (i.e., paid for by the user, either on its own or as part of another service or bundle of products) or provided free of charge to users.
- **Overseas firms** who provide ESG ratings to UK users by way of a business relationship. The reference to a "business relationship" means that for overseas ESG ratings providers, paid-for ratings and ratings that are provided as part of a broader commercial arrangement will be in scope, whether by way of a subscription model or any other contractual relationship (including as part of a bundle of products or services) to a person located in the UK. However, non-UK providers who restrict UK distribution/use, should not fall within scope as a result of a UK user inadvertently gaining access to that provider's rating. This will require careful disclosure and controls to be in place.

## **UK substance and third country access**

As part of its upcoming consultation on the ESG ratings regime, the FCA will also consider whether a non-UK rating providers will be required to have a physical presence in the UK. Factors that the FCA will consider in reaching a conclusion will include: size, significance, or market impact in the UK.

The government is also exploring the possibility of creating an overseas ESG Ratings regime as an alternative to requiring full UK authorisation.

## **Timing**

The Draft SI is open for comments from market participants until 14 January 2025. The FCA is expected to publish its consultation paper in due course.

## **Key issues for firms**

- The definition of ESG rating is broad, so firms will need to consider whether their products are in scope;
- There are exclusions for private ESG ratings, intragroup ratings, and ratings developed in the course of conducting another regulated activity, but the application will need to be carefully considered, applied, and documented by firms;
- Whilst there are some similarities with the definition of an EU ESG rating, they are not entirely the same so a gap analysis will need to be undertaken to assess the differences and the likely impact; and
- The extra-territorial application means that ESG ratings providers that market their ratings to UK users may fall in scope. This will need to form part of the initial gap analysis process.

## **How can DLA Piper help?**

DLA Piper can assist, and support firms as follows:

- What activities and services are in and out of scope?
- What exclusion is applicable? What does this mean?
- Applying for authorisation, registration, or a variation of permission.
- How to implement the conduct requirements (once published by the FCA).
- Updating and enhancing policies, procedures, and controls.
- Reviewing licensing and other agreement.
- Providing training to staff on new procedures and controls.

If you have any questions, please contact [Karen Butler](#) (Partner, DLA Piper).