8 June 2022

Response to the European Commission's consultation on ESG ratings and sustainability risks in credit ratings for an impact assessment

The European Association of Corporate Treasurers (EACT) appreciates the opportunity for stakeholders to express their views on how the European Union views the functioning of ESG ratings and possible solutions.

As background, the EACT brings together 14 000 corporate treasury professionals active in 22 countries and working for around 6500 individual non-financial companies. Corporate Treasurers rely on credit ratings for their companies' financing operations as well as issuance.

Field Code Changed

Part A: ESG ratings

EACT's members recognise the growing impact of ESG ratings and its impacts on the access to capital markets as well as bank financing. Generally speaking, the ESG rating agency offer is fragmented and very heterogeneous in quality. Due to the wide range of ratings available, methodologies remain very heterogeneous which leads to a lack of clarity and alignment in the way rating agencies classify risks. Agencies often make their assessment without seeking to exchange with the companies concerned, leading them to base their ratings on outdated and unreliable information on the companies that they assess is often limited. The quality and reliability of their rating is therefore often doubtful. A great deal of information contributing to the rating is often computed automatically, which means that less information and explanations on the weighting contributing to the final rating ~~are able to~~can be offered to companies. At this point, only a limited number of ESG rating agencies communicate the underlying indicators or their weighting in the final rating. In particular, certain ratings tend to exclude certain activities as un~~non-~~sustainable without any factual or objective basis. As methodologies are not published, issuers face difficulties in understanding and comparing their ESG ratings. For this reason, EACT's members would welcome more transparency on where exclusions apply and how data is assessed. Any exclusion should be rooted in regulation ~~accepted by the EU institutions~~agreed upon by co-legislators. EACT's members would also consider it useful ~~to~~for companies to have ~~ensure an~~ access ~~by companies~~ to the analyst within the agency responsible for their assessment, to ensure proper access to companies' up-‑to-‑date information and quality of ESG ratings. ~~This~~ All these present~~s~~ ~~a~~ major concerns, as unaligned methodologies, the lack of comparability and opaque ratings make it more difficult for companies and investors to understand and compare ratings which increases the risk of inefficient flows of capital to issuing companies.

To address some of these concerns, EACT recommends to better oversee ESG rating providers, by asking for more transparency on data sources and methods used by the rating agency. It is important to ensure the accuracy of the data as well as to ~~take into account~~consider the date of the data. More reliable ESG ratings and a better understanding of what they assess would strengthen the confidence of this growing market and its credibility for all players, especially since ESG ratings will be crucial to finance the green transition.

In addition, it is essential to oversee the business model of ESG rating providers to avoid conflicts of interest between advisory services and rating services. Harmonisation of data collection will also contribute towards a growing market in this area. Therefore, the ongoing efforts related to corporate sustainability reporting (CSRD) will standardise ESG which will reduce the time-consuming collection of data for the relevant rating questionnaires.

At the same time, EACT recommends drawing inspiration from the December 2020 report that the French AMF and the Dutch AFM which recommend that any rated entity should have the right of recourse to 'offer issuers the right to check the accuracy of the data used by the provider.' In addition, we would recommend that ratings providers should notify companies of new rating before these are made available to the public.

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Furthermore, ensuring data is up to date is crucial to accurate and comparable ratings. Indicators such as the date of the data will help maintain trustworthy attitudes towards ratings.

Moreover, to strengthen the Capital Markets Union, ESG rating providers should be overseen at the European level to ensure the comparability and reliability of these ratings. To support these aims, EACT believes that the European Commission should ensure market conditions which encourage new market entries and allow for a high degree of competitiveness among ESG rating providers.

Part B: Incorporation of ESG factors in credit ratings

The EU legal framework for credit rating agencies currently in place has proven stable and suitable. The requirements to register with ESMA alongside the publication of methodologies has led to the emergence of a credit rating market that is considered reliable by issuers and trusted by investors.

EACT understands the need to take ESG factors into account in credit ratings due to increasing sustainability risk. However, in line with ESMA's position, a lack of transparency remains as it is not clear to which extent ESG factors influence changes in credit ratings. To address potential shortcomings in this area, standardised guidelines on how credit rating agencies should inform investors about ESG risks could be updated by ESMA.

THE EUROPEAN ASSOCIATION OF CORPORATE TREASURERS

8 June 2022

Responses to specific questions (in addition to the full letter):

Part A: ESG ratings

Do you have access to ESG ratings of your own company?

EACT's members recognise the growing impact of ESG ratings and its impacts on the access to capital markets as well as bank financing. Generally speaking, the ESG rating agency offer is fragmented and very heterogeneous in quality. Due to the wide range of ratings available, methodologies remain very heterogeneous which leads to a lack of clarity and alignment in the way rating agencies classify risks. Agencies often make their assessment without seeking to exchange with the companies concerned, leading them to base their ratings on outdated and unreliable information on the companies that they assess is often limited. The quality and reliability of their rating is therefore often doubtful. A great deal of information contributing to the rating is often computed automatically, which means that less information and explanations on the weighting contributing to the final rating can be offered to companies. At this point, only a limited number of ESG rating agencies communicate the underlying indicators or their weighting in the final rating. In particular, certain ratings tend to exclude certain activities as unsustainable without any factual or objective basis. As methodologies are not published, issuers face difficulties in understanding and comparing their ESG ratings. For this reason, EACT's members would welcome more transparency on where exclusions apply and how data is assessed. Any exclusion should be rooted in regulation agreed upon by co-legislators. EACT's members would also consider it useful for companies to have access to the analyst within the agency responsible for their assessment, to ensure proper access to company's up-to-date information and quality of ESG ratings. All these present major concerns, as unaligned methodologies, the lack of comparability and opaque ratings make it more difficult for companies and investors to understand and compare ratings which increases the risk of inefficient flows of capital to issuing companies.

II. Functioning of the ESG ratings market

How do you consider that the market of ESG ratings is functioning today?

EACT recommends to better oversee ESG rating providers, by asking for more transparency on data sources and methods used by the rating agency. It is important to ensure the accuracy of the data as well as to consider the date of the data. More reliable ESG ratings and a better understanding of what they assess would strengthen the confidence of this growing market and its credibility for all players, especially since ESG ratings will be crucial to finance the green transition.

In addition, it is essential to oversee the business model of ESG rating providers to avoid conflicts of interest between advisory services and rating services. Harmonisation of data collection will also contribute towards a growing market in this area. Therefore, the ongoing efforts related to corporate sustainability reporting (CSRD) will standardise ESG which will reduce the time-consuming collection of data for the relevant rating questionnaires.

At the same time, EACT recommends drawing inspiration from the December 2020 report that the French AMF and the Dutch AFM which recommend that any rated entity should have the right of recourse to 'offer issuers the right to check the accuracy of the data used by the provider.' In addition, we would recommend that ratings providers should notify companies of new rating before these are made available to the public.

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Furthermore, ensuring data is up to date is crucial to accurate and comparable ratings. Indicators such as the date of the data will help maintain trustworthy attitudes towards ratings.

III. EU intervention

Taking into account your responses to the previous sections, do you consider that there is a need for an intervention at EU level to remedy the issues identified on the ESG rating market? - Yes

EACT believes a European approach would be best suited to address the inconsistencies and heterogeneity prevalent in the ESG rating market.
In line with strengthening the Capital Markets Union, ESG rating providers should be overseen at the European level to ensure the comparability and reliability of these ratings. With many of our corporate members operating on an EU-wide basis, EACT would strongly favour a harmonised approach to the oversight of ESG rating providers, comparable to the current EU framework for credit rating agencies.
To support these aims, EACT believes that the European Commission should ensure market conditions that encourage new market entries and allow for a high degree of competitiveness among ESG rating providers.

Part B: Incorporation of ESG factors in credit ratings
III. Questions on the need for EU intervention (all respondents)

Do you consider that the current trends in the market and application of ESMA guidelines on disclosure applicable to CRAs are sufficient to ensure understanding among users as to how ESG factors influence credit ratings? - Yes

Regarding the possible regulatory intervention, what type of requirements do you find relevant?

The EU legal framework for credit rating agencies currently in place has proven stable and suitable. The requirements to register with ESMA alongside the publication of methodologies has led to the emergence of a credit rating market that is considered reliable by issuers and trusted by investors.

EACT understands the need to take ESG factors into account in credit ratings due to increasing sustainability risk. However, in line with ESMA's position, a lack of transparency remains as it is not clear to which extent ESG factors influence changes in credit ratings. To address potential shortcomings in this area, standardised guidelines on how credit rating agencies should inform investors about ESG risks could be updated by ESMA.