

CONTENT

Environmental, Social and Governance (ESG) rating activities play an important role in the EU sustainable finance market as they provide information to investors and financial institutions regarding, for example, investment strategies and risk management on ESG factors.

ESG ratings have an increasingly important impact on the operation of capital markets and on investor confidence in sustainable products. The market of ESG ratings is expected to continue to grow substantially in the coming years.

According to Commission, 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.

On 13 June 2023, the Commission presented a proposal on a Regulation on transparency and integrity of ESG rating activities, as part of its renewed sustainable finance strategy, launched in 2021.

The proposal aims to improve the reliability, comparability and transparency of ESG ratings. More specifically, it 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.

The 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).

On 10 July 2023, the Committee on Economic and Monetary Affairs (ECON) has been referred as the committee responsible of the dossier. MEP Aurore Lalucq is the ECON rapporteur.

On 6 October 2023, the Rapporteur has published her draft report.

On 4 December 2023, the Committee voted on the report, and on the decision to open interinstitutional negotiations.

On 13 December 2023, the Committee report and the decision to enter into interinstitutional negotiations was confirmed by the Parliament plenary, according to rule 71 of Rules of procedures.

The Parliament suggested changes to the Commission proposal, in terms of: 1) considering the ESG rating into separate E, S and G factors; 2) introducing a "double materiality" approach and 3) supporting transparency and competition.

On 20 December 2023, also the Council reached an agreement on its negotiating mandate on the file.

On 5 February 2024, after interinstitutional negotiations, the Parliament and the Council reached a provisional agreement.

The Council and the Parliament clarified the circumstances under which ESG ratings fall under the scope of the regulation, providing further details on the applicable exclusions. The agreement also clarifies the territorial scope of the regulation, by setting out what constitutes operating in the EU.

The Council and Parliament agreed that if financial market participants or financial advisers disclose ESG ratings as part of their marketing communications, they will include information about the methodologies used in such ESG ratings on their website. This was done through an amendment of the Sustainable Finance Disclosure Regulation.

The agreement clarifies that ESG ratings encompass environmental, social and human rights or governance factors. The agreement foresees the possibility to provide separate E, S and G ratings. However, if a single rating is provided, the weighting of the E, S and G factors should be explicit.

ESG rating providers established in the EU will need to obtain an authorisation from ESMA. ESG rating providers established outside the EU that wish to operate in the EU will need to obtain an endorsement of their ESG ratings by an EU authorised ESG rating provider, a recognition based on a quantitative criterion or be included in the EU registry of ESG rating providers on the basis of an equivalence decision in relation to the country of its origin and following a dialogue held between ESMA and the relevant third-country competent authority.

The Council and Parliament introduced a lighter, temporary and optional registration regime of three years for small undertakings and groups providing ESG ratings. Small ESG rating providers who opt in under the lighter regime will benefit from supervisory fees proportionate to the extent of ESMA supervision. They will have to comply with some general organisational and governance principles, as well as transparency requirements vis-à-vis the public and users.

The agreement introduces as a principle a separation of business and activities, with a possibility for ESG ratings providers not to set up a separate legal entity for certain activities, provided that there is a clear separation between activities and that they put in place measures to avoid potential conflicts of interests. However, this derogation would not apply to ESG rating providers that carry out consulting activities, audit activities and credit rating activities.

The provisional agreement was endorsed by ECON on 22 February 2024. On 24 April 2024, the plenary adopted the final text.

On 19 November 2024, the Council formally approved the agreed text.

On 12 December 2024, the new regulation has been published in the Official Journal of the European Union. It enters into force on 1 January 2025, and it shall from 18 months after the entry into force.

References:

- European Parliament Legislative Observatory, Procedural file on [Transparency and integrity of Environmental, Social and Governance \(ESG\) rating activities](#), 2023/0177(COD).
- European Commission, [Proposal for a Regulation on the transparency and integrity of Environmental, Social and Governance \(ESG\) rating activities](#), COM(2023)314.
- European Commission, [Impact assessment accompanying the proposal](#), SWD/2023/204.
- European Commission, [Sustainable Finance: Commission takes further steps to boost investment for a sustainable future, press release](#), 13 June 2023.
- Council of the European Union, [Sustainable finance: Council agrees negotiating mandate on ESG ratings](#), press release, 20 December 2023

Further reading:

- European Parliament, EPRS, [Transparency and integrity of environmental, social and governance rating activities](#), November 2023.
- European Parliament, EPRS, [Green and sustainable finance](#), February 2021.
- European Parliament, EPRS, [European green bond standard](#), Briefing, October 2021.

Author: Stefano Spinaci, Members' Research Service, legislative-train@europarl.europa.eu
As of 15 December 2024.



RAPPEUR
Aurore LALUCQ
ECON - CULT