Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Telephone: 020 7066 9346
Email: enquiries@fs-cp.org.uk

29 June 2023

By email: ESGRatingsConsultation@hmtreasury.gov.uk

Dear Sir / Madam,

**Financial Services Consumer Panel response to HMT consultation on Future regulatory regime for Environmental, Social, and Governance (ESG) ratings providers**

The Financial Services Consumer Panel (the Panel) is an independent statutory body. We represent the interests of individual and small business consumers in the development of financial services policy and regulation in the UK.

We welcome the opportunity to respond to this consultation on ESG ratings providers. The Panel broadly supports the main proposals set out in this consultation. In particular, the Panel supports proposals to ensure ESG ratings providers that supply UK users with ratings will need to be regulated regardless of their own jurisdiction.

While the Panel is also supportive of the idea that small ESG ratings providers might be subject to a lower level of regulation, it considers that thought needs to be given to the size of a provider's client base, not purely the size of the provider itself. Where a small ESG ratings provider has one or more large clients, then it may need to be included within the regulatory perimeter in recognition of its likely impact on the market.

The Panel also considers that thought will need to be given to whether the proposals will ensure that the activities needed to support the FCA's proposed new sustainability labelling regime will be subject to appropriate regulation. Having an effective ESG labelling regime for retail financial products is important and will help reduce greenwashing and increase confidence in the market. The Panel would also question what protection or measures there would be to ensure the charity exclusion will not be used to avoid regulation.

In general the Panel considers it important that the overarching regulatory regime governing retail investments, including retail disclosure requirements, provides a coherent approach to setting regulation that meets consumers' needs. Our response should be considered in the context of our vision for how the market should function, which is set out in our response to the FCA's call for input on consumer investments. The foundation of this vision is a correctly implemented and supervised Consumer Duty[1]. This would make the firm responsible for consumers' overall suitability for and understanding of the products which they invest in. This would create a market where:

[1] For our comments on the FCA's proposed new Consumer Duty, please see here: https://www.fs-cp.org.uk/sites/default/files/final_fscp_response_cp21-36_a_new_consumer_duty_20220214.pdf

- more of the population with investible assets, and where the decision is right for them, make an active and informed choice to invest, so maximising their own returns and supporting the real economy;
- the information disclosed to potential investors, including on ESG, is designed in a way that will allow them to make effective decisions, and to compare the risks, rewards and sustainability not only of different options for a given product type, but also of different products;
- it is not possible to use regulatory arbitrage to circumvent rules designed to protect consumers;
- the use of client self-certification is removed;
- information, education, guidance and advice is readily available and tailored to the consumer to ensure they are supported in taking decisions both pre-investment and on an ongoing basis. This will require the re-engineering of current thinking to better integrate these aspects and blend them throughout the customer's investment life-cycle. Only in this way will trust be established;
- the use of guidance or advice should be the gateway to anything other than a range of default-based, simple, tax-efficient investments;
- products must be better designed, labelled and described to enable consumers to better understand fully the opportunities, risks and costs involved and easily compare these across options; and
- when harm does occur, there must be easily accessible and efficient redress and compensation solutions.

Our responses to the questions posed in the consultation are included at Annex A below.

Yours sincerely,

Helen Charlton

Chair, Financial Services Consumer Panel

# Annex A – responses to questions

**Q1. Do you agree that regulation should be introduced for ESG ratings providers?**

Yes. The Financial Services Consumer Panel (the Panel) supports proposals to include ESG rating providers within regulation. It is important that both consumers and their advisers can rely on ESG ratings, in order to inform their investment choices. Concerns about greenwashing can damage confidence in the market. As identified within this consultation, bringing ESG rating providers within the regulatory perimeter will provide a framework that will help manage a range of potential harms, including conflicts of interest.

The Panel notes that the FCA has recently consulted on proposals for an ambitious new ESG labelling regime. The Panel is supportive of the FCA's ambitions, and considers ensuring there is a robust sustainability labelling regime, which aims to eliminate greenwashing, will help provide confidence in the market.[2] The introduction of regulation for ESG ratings providers therefore has the potential to help support this new regime, by ensuring it is underpinned by robust information and analysis, which will help ensure market confidence.

**Q2. (For ESG ratings providers) If your firm were subject to regulation in line with IOSCO's recommendations, and aimed at delivering the four key regulatory outcomes in Figure 1.A, how would this impact your business? Please provide information on the size of your business when answering this question.**

No comment.

**Q3. Are there any practical challenges arising from overlap between potential regulation for ESG ratings providers and existing regulation?**

No comment.

**Q4. Are there any other practical challenges to introducing such regulation?**

No comment.

**Q5. Do you agree with the proposed description of an ESG rating?**

Yes. The Panel agrees that an ESG rating should be taken to mean any form of ESG assessment, regardless of the label used to describe it (rating, score, or mark for example).

**Q6. Do you agree that ESG data, where no assessment is present, should be excluded from regulation?**

In principle the Panel agrees that ESG data providers should remain unregulated, with only ESG rating providers being brought within the regulatory perimeter.

However, the Panel notes that in practice a significant amount of judgement is needed in the measurement of data, including judgement about:

- the definition of what is being measured,
- what underlying data are included,

---

[2] See the Panel's response to FCA consultation on Sustainability Disclosure Requirements (SDR) and investment labels – CP22/20.

- what units of measurements are used and,
- if an index is used to combine data:
    - how they are weighted and
    - which calculation methodology is used (for example, arithmetic or geometric mean).

All these decisions will influence the final answer, and once the data are produced there is nothing to prevent them being used to rank different options. This may make the line between an ESG data provider and an ESG ratings provider blurry and the Panel considers that this is something the Government will need to keep under review.

In general, the Panel is sceptical of industry led Codes of Conduct, because it considers that the incentives will not necessarily be aligned with the needs of consumers. It therefore considers that any reliance on an industry Code of Conduct, even if only for part of the market, will need to be carefully monitored to ensure it will be effective.

**Q7. Do you agree with the proposal to regulate the activity of providing ESG ratings to be used in relation to RAO specified investments?**

The Panel broadly supports the idea of only bringing ESG ratings activities within the regulatory perimeter where they relate to regulated financial products. However, the Panel notes that the Government may need to consider including providers of ESG ratings of corporate entities, if those ratings are then used to inform investment options.

The Panel does not have a settled view on the most appropriate legal mechanism to identify which ESG rating activities to include, but based on the information in this consultation considers that use of the Regulated Activities Order to inform the type of activity included is likely to be sensible.

**Q8. (For ESG ratings providers) Do you know when an ESG rating you provide will be used in relation to a specified investment?**

No comment.

**Q9. Are there ESG ratings used in relation to anything other than an RAO specified investment which also should be included in regulation?**

The Panel notes that the Government may need to consider including providers of ESG ratings of corporate entities, if those ratings are then used to inform investment options.

In light of the FCA's emerging proposals on ESG labelling for investment products, the Panel also considers that it would be helpful to check that all the rating activities needed to assess whether investment options qualify for one of the proposed sustainability labels will be covered. This is likely to be particularly important in relation to the "Sustainability Improvers" category, where an assessment is likely to be needed in relation to the effectiveness of any active investor stewardship and engagement, rather than an ESG rating of any underlying assets.

**Q10. Do you agree that each of the eight scenarios listed above (in paragraphs 3.2, 3.3, and 3.5) should be excluded from regulation?**

The Panel is broadly supportive of the exemptions proposed. However, it notes two potential caveats, where more consideration may be needed to ensure the potential harms associated with ESG ratings are avoided:

- Just because a charity is undertaking an ESG assessment does not exempt it from a potential conflict of interest.

- Consideration may need to be given to the operation of proxy advisor services (such as voting recommendations) and how they are regulated in cases where they will be used in relation to the FCA's proposed "Sustainability Improvers" category.

**Q11. Are there any other exclusions which should be provided for?**

No comment.

**Q12. Do you agree with the proposal to regulate the direct provision of ratings to users in the UK, regardless of the location of the provider?**

Yes. The Panel supports the proposal that ESG rating providers who provide information used by UK consumers and their advisers should be regulated in the UK regardless of where they are located. The Panel notes that the Government will need to consider how it treats financial products that are sold in the UK, but are manufactured abroad, where the manufacturers may have used unregulated (by the UK) ESG ratings providers.

**Q13. (For UK users of ESG ratings) Are you concerned that this proposal would hamper the choice of ESG ratings available to you?**

The Panel notes that the ESG ratings market is already highly concentrated, which means there is a risk of insufficient competition in the market if one (or more) of the big ratings providers were to withdraw from the UK. However, the Panel notes that UK financial markets are sizeable and well developed. It therefore considers that there is likely to be sufficient incentive for ESG rating providers to continue to serve this market. However, if further concentration of the market occurs, then this may push up the price of products to the detriment of consumers. The Panel therefore considers that this is an issue that will need to be kept under review.

**Q14. Should any instances of direct provision of ESG ratings to users in the UK be excluded from regulation (for example, the provision of ESG ratings to UK branches of overseas firms, or to retail users who are temporarily physically located in the UK)?**

No comment.

**Q15. Are there any scenarios of indirect provision of ESG ratings to UK users which should also be regulated?**

The Panel agrees that careful consideration will need to be given to the scenarios identified in this consultation, including the use of unregulated, foreign ESG rating providers by intermediaries, particularly where these intermediaries advise UK consumers.

**Q16. How would the territorial scope proposed in this chapter interact with initiatives related to ESG ratings in other jurisdictions, such as proposals for regulation or codes of conduct?**

No comment.

**Q17. Should smaller ESG ratings providers be subject to fewer or less burdensome requirements?**

The Panel is broadly supportive of the fact that smaller ESG rating providers are subject to a lower level of regulation so long as this has no negative impact on the consumer outcome. However, it notes that this may not be appropriate, if a small ESG provider is being used by a large provider of (particularly retail) financial services. In such cases the small ESG provider may have a significant influence on market outcomes, because of the size of its client. This may suggest that the decision about where to set the regulatory barrier may need to take into account the impact of the ESG ratings provider within the market, not purely its size.

**Q18. (For ESG ratings providers) What impact would an authorisation requirement have on your business? Please provide information on the size of your business when answering this question.**

No comment.

**Q19. Do you have any views on an opt-in mechanism for smaller providers?**

The Panel considers that allowing smaller providers to opt-in to regulation, where they consider it would give them a competitive advantage, is a sensible approach.

**Q20. What criteria should be used when evaluating the size of ESG ratings providers?**

No comment.

**Q21. What level could the criteria for small ratings providers be set at (i.e., how could 'small ratings provider' be defined)?**

The Panel has no specific comments on how the size of "small" ESG providers should be set (and hence where the regulatory barrier should be), beyond suggesting that it would also be helpful to consider a metric linked to providers' influence in the market. If a small ESG provider has a large client, it may have significant influence in the market despite its size.

**Q22. Is there anything else you think HM Treasury should consider in potential legislation to regulate ESG rating providers?**

No comment.