FCA
Cost Benefit Analysis Panel

03/10/25

Consultation Paper title	**ESG (Environmental, Social, Governance) ratings: Proposed approach to regulation**
Summary of intervention	In September/October 2025, the Government legislated to bring ESG ratings into our regulation. The Treasury's Statutory Instrument (SI) defines an ESG rating as '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'. From October/November 2028, providing an ESG rating will be a regulated activity, and firms will need to be authorised by us to do so.
Feedback date of issue	03/10/2025
CBA Panel reference number	CBAP-0011

CBA Panel advice

Overall the Panel thought the CBA was well written, clear about the market and its failures, the intervention and the policy options deriving from the HMT SI.

Main recommendations

- **Improve assessment of costs and benefits.** The Panel recommends that the CBA be improved in two ways; firstly, by properly scrutinising the mathematical mechanics of the CBA – in some cases, the review found purported error in calculation. Secondly, by considering further some individual costs and benefits; much of the CBA conducts in-depth assessment of relatively minor costs when compared with benefits, whilst other benefits are not included e.g. potentially qualitative second-order effects of ESG ratings on market stability and capital allocation.

- **Strengthen the evidence around assumptions**. The Panel recognises that it is difficult to be certain around the scale of the benefits derived from assumptions. There is likely to be many small suppliers, against which the costs and benefits may align differently. At present the CBA uses assumptions around efficiency gains which lead to a large NPV, with benefits dwarfing costs.

- **Recognise more clearly the uncertainty.** The Panel commends the team for undertaking thorough sensitivity analysis, however, in applying the upper bounds to all scenarios this leads to a suspected statistical anomaly whereby the ranges of costs and benefits are extremely large. It is recommended that the team consider whether these ranges are truly applicable in this case. Furthermore, the causality of cost factors like job losses may be less certain with references to developments in AI etc.

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Summary

Category	CBA Panel comments
The market	**The market:** overall, this section is well written and comprehensive.
	Problem and rationale for intervention: The problem and rationale for intervention is clearly articulated. However, there could also be reference to the inherent dynamics of competition amongst Rating Providers inhibiting the market. Rating providers are likely to face a tension between transparency, and the commercial sensitivity of their proprietary rating methodology.
	Proposed intervention and alternative options: There are no alternative options due to the nature of the HMT SI, but this is made clear within the CBA. The Panel notes that there is a lack of evidence as to why certain parts of the FCA Handbook are/are not applied in this case e.g. prudential requirements or extending the DISP/COMP sourcebooks to ESGRPs. There is also a section around market abuse in the CP which does not feature in the CBA.
Assessment of costs and benefits	**Baseline and rationale for intervention:** No further comments.
	Evidence and data: The Panel not that although the evidence and data collected was clear, that care should be placed when inferring causality from the policy and the result. It was also noted that there is a large discrepancy between the reported FTE resources required for systems and controls, and that estimated by the SCM, this should be explained in more detail.
	Assumptions: The Panel notes that the assumption around 75% reduced efficiency losses drives all of the quantified benefits; many of the benefits are unquantified. Although sensitivity analysis is conducted on these benefits, the range is so large, there is a question around its efficacy.
	Economic analysis: The Panel recommends the impact summary tables are revisited, to ensure PV Benefits – PV costs = NPV. It also questions why a market solution would not be provided that would enable the users to share some of the £80m a year benefits from more robust ratings with the providers, providing benefits to both parties without the need for regulatory intervention, given the relatively low ongoing PV annual cost of ~£6m – this should be explained.
Risk and uncertainty	The Panel recognises the sensitivity analysis undertaken is comprehensive, however in applying the upper bound of all inputs, it creates very large ranges, which may not be as representative as they could be.
Wider economic impacts	The Panel recommends that, even if qualitatively, thought be given to potential second-order effects of the regulation. For example, driving market stability and reducing the potential risk of pockets of concentration risk being built up, as firms rely on third-party ESG ratings to inform capital allocation decisions and risk management. There was also a question as to whether these sorts of regulations could reduce the incentive to list in the UK, either by keeping UK

	companies private or incentivising them to list in rival stock exchanges instead.