

HM Treasury launches proposals to regulate ESG ratings providers

AT A GLANCE

April 2023

What's new?

- HM Treasury (HMT) [published a consultation](#) on 30 March 2023 setting out proposals to bring ESG rating providers into the regulatory perimeter. It first announced its intention to regulate providers as part of the [Edinburgh Reforms](#) package in December 2022.
- The consultation proposes bringing ESG rating providers within the FCA's remit, where their assessment is used in relation to a regulated investment, unless an exclusion applies. This would apply to information used in relation to regulated activities within the UK, irrespective of the location of the provider.

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What does this mean?

- Although the FCA [invited feedback](#) in 2021 on the regulation of both ESG data and ratings providers, this consultation proposes bringing only ratings providers within the FCA's regulatory remit. HMT notes that this is the area with the most risk of harm, and that the risks associated with the processing of raw data may be addressed by the emerging International Sustainability Standards Board standards.
- The proposals would apply to any rating service, irrespective of how they are named or marketed, as long as they provide an assessment of E, S, or G factors (irrespective of whether they use the label).
- However, the following exclusions from the regulation are proposed: not for profits; ratings used solely by the entity that generated them; credit ratings which consider the impact of ESG on creditworthiness; investment research products; external reviewers, including third party verifiers; consulting services; proxy advisor services; academic research or journalism. The new legislation would also not apply to proxy data providers.
- The consultation seeks views on the best way to ensure proportionality, with a number of options being suggested on how smaller organisations should be considered. These include a complete exclusion from the regulation, different requirements for smaller organisations, or a voluntary opt in option.
- HMT expects that any requirements developed by the FCA following this legislation would take into account international developments, in particular the recommendations provided by International Organisation of Securities Commissions (IOSCO). The FCA has similarly noted its support for the IOSCO recommendations.

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What do firms need to do?

- Providers of data services that may be in scope of the proposals should take note of the IOSCO recommendations in relation to transparency, independence, conflicts of interest, disclosure, and the treatment of non public information, and assess these against their own approach.
- Asset managers and investors should review their dependencies on external service providers, and ensure due diligence is performed, as outlined in the [FCA's Dear AFM Letter](#) of July 2021.
- Users of ratings providers should map out dependencies, to better understand whether they are UK based, and whether the proposed legislation would apply.
- Firms should look out for the FCA Code of Conduct, due to be published later this year, which will be voluntary, but may inform future expectations.

Next steps

The consultation closes for comment on 30 June 2023, and HMT is expected to progress with legislation shortly after. The FCA's Working Group on a voluntary Code of Conduct is due to consult on a draft in June 2023, and issue a finalised code by the end of 2023.



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