

European Commission Publishes Proposal on Regulating ESG Rating Providers

June 28, 2023

Environmental, Social and Governance (“ESG”) factors play an increasingly important role in financial markets, as industry participants integrate ESG into their activities, product offerings and investments. Firms and consumers increasingly rely on providers of data on such factors, including ESG ratings.

Recognising the importance of ensuring adequate standards of ESG ratings, on June 13, 2023, the European Commission published a proposal for a regulation on the transparency and integrity of ESG rating activities (the “**Proposal**”).

This alert memorandum sets out the key points of the Proposal, explores its wider implications, and draws comparisons with parallel developments in the UK.

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors

PARIS



Amélie Champsaur
+33 1 40 74 68 95
achampsaur@cgsh.com

LONDON



Ferdisha Snagg
+44 20 7614 2251
fsnagg@cgsh.com



Andreas Wildner
+44 20 7614 2248
awildner@cgsh.com



I. Context

The Proposal forms part of the EU's ongoing efforts to transition to a sustainable economy: specifically, the Commission's action plan on 'Financing Sustainable Growth' (the "Action Plan")¹ and renewed sustainable finance strategy in the context of the 'European Green Deal'.²

The objectives of the Action Plan include reorienting capital flows towards sustainable investment to achieve sustainable growth. As part of the Action Plan, the Commission commissioned a study on sustainability-related ratings,³ which identified the need for greater transparency and accuracy with respect to the methodologies employed by ESG ratings providers and for more clarity with respect to the objectives, meaning and limitations of various products. In 2022, the Commission published a consultation on ESG ratings,⁴ the responses to which voiced similar concerns.

Like its counterpart policy-makers in the UK, the Commission is live to the increasingly important role played by ESG ratings in global markets, driven in no small part by the explosion of sustainable finance regulation in the EU and elsewhere. ESG ratings provide information for investment strategies, risk management and disclosure obligations.

To improve standards of quality, reliability and comparability of ESG ratings provided in the EU (and to ensure that such standards are common across the single market), the Proposal aims to ensure that ESG rating activities are conducted in accordance with principles of integrity, transparency, responsibility and good governance.

In outline, the Proposal would introduce an authorisation regime, requiring EU-based providers to apply ESMA for authorisation and comply with

substantive obligations (which are derived from IOSCO's recommendations) on an ongoing basis. The Proposal would also capture ESG ratings provided to EU users by third-country providers, and would introduce three alternative regimes under which third-country providers can provide services into the EU.

II. Scope

In general, an ESG rating would fall within the Proposal where:

- a. it comprises "an opinion,⁵ a score⁶ or a combination of both, regarding an entity, a financial instrument, a financial product, or an undertaking's ESG profile or characteristics or exposure to ESG risks or the impact on people, society and the environment, that are based on an established methodology and defined ranking system of rating categories and that are provided to third parties, irrespective of whether such ESG rating is explicitly labelled as 'rating' or 'ESG score'";
- b. it is issued by a provider (i.e., legal person who offers and distributes ESG ratings on a professional basis) operating in the EU; and
- c. it is (a) disclosed publicly, or (b) distributed to 'regulated financial undertakings'⁷ in the Union, undertakings that fall under the scope of the Accounting Directive,⁸ or EU/Member States public authorities.

A number of types of ESG ratings would be exempted from, and therefore not subject to the rules of, the Proposal:

- a. private ESG ratings produced pursuant to an individual order and provided exclusively to the person who placed the order and which are not

¹ The Action Plan is accessible [here](#).

² The Green Deal is accessible [here](#), and our firm's detailed analysis of the Green Deal is accessible [here](#). The EU's renewed sustainable finance strategy, adopted in 2021, is accessible [here](#).

³ The Commission's 'Study on Sustainability Related Ratings, Data and Research' is accessible [here](#).

⁴ The Commission's targeted consultation on the functioning of the ESG ratings market in the European Union and on the consideration of ESG factors in credit ratings is accessible [here](#).

⁵ 'Opinion', in this connection, means "an assessment that [is] based on a rules-based methodology and defined ranking

system of rating categories, involving directly a rating analyst in the rating process or systems process"

⁶ 'Score' means "a measure derived from data, using a rule-based methodology, and based only on a pre-established statistical or algorithmic system or model, without any additional substantial analytical input from an analyst".

⁷ Article 3(5) of the Proposal sets out a list of definitions of entities that would qualify as 'regulated financial undertakings', such as credit institutions and investment firms. It is not entirely clear whether that covers only financial undertakings that are *established* in the EU, or would also cover, for example, EU branches of third-country firms.

⁸ Directive 2013/34/EU, accessible [here](#).

- intended for public disclosure or distribution by subscription or other means;
- b. ESG ratings produced by regulated financial undertakings in the Union that are used for internal purposes or for providing in-house financial services and products;
 - c. ESG data that do not include an element of rating or scoring and are not subject to any modelling or analysis resulting in the development of an ESG rating;
 - d. Credit ratings issued pursuant to Regulation (EC) No 1060/2009 (the Credit Ratings Agencies Regulation);
 - e. products or services that incorporate an element of an ESG rating;
 - f. second-party opinions on sustainability bonds;
 - g. ESG ratings produced by EU or Member States' public authorities;
 - h. ESG ratings from an authorised ESG rating provider that are made available to users by a third party; and
 - i. ESG ratings produced by central banks that fulfil all of the following conditions: (i) they are not paid for by the rated entity; (ii) they are not disclosed to the public; (iii) they are provided in accordance with the principles, standards and procedures which ensure the adequacy, integrity and independence of rating activities, as provided for by this Regulation; and (iv) they do not relate to financial instruments issued by the respective central banks' Member States.

III. Provision of ESG ratings in the EU

Under the Proposal, ESG ratings could only be provided by an authorised provider or under one of three regimes for third-country entities.

Authorisation Regime (EU providers)

Providers established in the EU would need to apply to the European Securities and Markets Authority ("ESMA") for authorisation. The Proposal sets out the information that would need to be provided as part of such application (with ESMA being mandated to further specify this information), the conditions for authorisation with which a provider would need to comply on an ongoing basis, and the procedure for the granting, suspension and withdrawal of such

authorisation. Authorised providers would be able to passport their ratings services across the EU.

Third-country providers

In respect of providers located outside the EU, the Proposal introduces three possible access routes: equivalence, endorsement and recognition.

Regarding the **equivalence** regime, third-country providers may provide ESG ratings in the EU where (i) they are authorised/registered as an ESG rating provider in the relevant third country; (ii) they have notified ESMA of their intention to provide ESG ratings in the EU; (iii) the Commission has adopted a decision (an equivalence decision) that the regulatory arrangements in that third country are equivalent to EU standards; and (iv) a cooperation agreement between ESMA and the relevant third-country competent authority is operational.

The **endorsement** regime allows EU-based authorised ESG rating providers to endorse ratings by third-country providers belonging to the same group. Such endorsement would need to be authorised by ESMA, and would also be subject to a number of further requirements.

The **recognition** regime allows smaller third-country ESG rating providers (with an annual net turnover on ESG rating activities below EUR 12 million for three consecutive years) to be recognised to provide, in the absence of endorsement or an effective equivalence decision, ESG ratings to regulated financial undertakings in the EU on the basis of recognition by ESMA. To become recognised, third-country providers would need to comply with the requirements under the Proposal and apply for recognition to ESMA.

ESMA register & accessibility of information on ESAP

The Proposal would require ESMA to establish a publicly accessible register containing the identities of all EU-based and third-country providers that may provide ESG ratings in the EU.

In addition, from 2028 onwards, information required to be disclosed under the Proposal (see below) would also need to be accessible via the European Single Access Point ("ESAP"), in order to provide an easy centralised access to such information.

IV. Organisational requirements for ESG rating providers

The Proposal would subject in-scope ESG rating providers to a number of organisational, process, governance and documentation requirements, comprising certain general principles supplemented by specific rules concerning separation of business and activities, rating analysts, employees and other persons involved in the provision of ESG ratings, record-keeping requirements, complaints-handling and outsourcing.

General principles:

- ESG rating providers shall ensure the **independence** of their rating activities, including from all political and economic influences or constraints.
- ESG rating providers shall have in place **rules and procedures** that ensure that their ESG ratings are provided and published or made available in accordance with this Regulation.
- ESG rating providers shall employ **systems, resources and procedures** that are adequate and effective to comply with their obligations under this Regulation.
- ESG rating providers shall adopt and implement **written policies and procedures** that ensure that their ESG ratings are based on a **thorough analysis of all relevant information** available to them.
- ESG rating providers shall adopt and implement internal **due diligence** policies and procedures that ensure that their business interests do not impair the **independence or accuracy** of the assessment activities.
- ESG rating providers shall adopt and implement sound **administrative and accounting procedures, internal control mechanisms**, and effective control and

safeguard arrangements for **information processing systems**.

- ESG rating providers shall use rating **methodologies** for the ESG ratings they provide that are **rigorous, systematic, objective** and **capable of validation** and shall apply those rating methodologies continuously.
- ESG rating providers shall **review** rating **methodologies** on an ongoing basis and **at least annually**.
- ESG rating providers shall **monitor and evaluate** the adequacy and effectiveness of the **systems, resources and procedures** (referred to above) at least **annually** and take appropriate measures to address any deficiencies.
- ESG rating providers shall establish and maintain a permanent and effective **oversight function** to ensure oversight of all aspects of the provision of their ESG ratings.
- ESG rating providers shall develop and maintain **robust procedures** regarding their oversight function.
- ESG rating providers shall adopt, implement and enforce measures to ensure that their ESG ratings are based on a thorough analysis of all the information that is available to them and that is relevant to their analysis in accordance with their rating methodologies. They shall adopt all necessary measures to ensure that the **information** they use in assigning ESG ratings is of **sufficient quality** and from **reliable sources**. ESG rating providers shall explicitly mention that their ESG ratings are their own opinion.
- ESG rating providers shall **not disclose** information about their intellectual capital, intellectual property, know-how

or the results of innovation that would qualify as **trade secrets**.

- ESG rating providers shall **only make changes** to their ESG ratings **in accordance with** their rating **methodologies**.

Separation of business and activities

To avoid potential conflicts of interest, ESG rating providers would not be allowed to offer a number of services, including consulting services, credit ratings, benchmarks, investment activities, audit, or banking, insurance and reinsurance activities. Providers would, moreover, need to ensure that any other services they offer do not create risks of conflicts of interest.

Analysts and employees

ESG rating providers would need to establish appropriate internal policies and procedures in relation to employees and other persons involved in the rating process. Specifically, such persons should:

- possess the knowledge and experience that is necessary for the performance of the duties and tasks assigned;
- take all reasonable measures to protect property and records in possession of the ESG rating provider from fraud, theft or misuse;
- not impermissibly share confidential information.

There are further requirements relating to persons involved in the rating process to address potential risks of conflicts of interest, including that such persons should:

- not initiate or participate in negotiations regarding fees or payments with any rated entity or any person linked to a rated entity;
- not buy or sell any financial instrument issued, guaranteed or otherwise supported by any rated entity;
- not have had a recent employment, business or other relationship with the rated entity, nor take up a key management position within a rated entity which they have been involved in rating for six months after the provision of such rating.

Record-keeping requirements

The Proposal would also introduce requirements to keep records and specifies certain information that should be kept for these purposes.⁹

Complaints-handling mechanism

The Proposal would require ESG rating providers to implement and publish procedures for receiving, investigating and retaining records concerning complaints made.

The Proposal further requires that complaints be investigated in a timely and fair manner and that the outcome of the investigation be communicated to the complainant within a reasonable period of time. Inquiries must be conducted independently of any personnel that has been involved in the matter giving rise to the complaint.

Outsourcing

ESG rating providers will not be able to outsource important operational functions where such outsourcing would materially impair the quality of the ESG rating provider's internal control policies and procedures, or ESMA's ability to supervise the ESG

⁹ The records that ESG rating providers would be required to keep include: (a) for each ESG rating in the form of an opinion, the identity of the rating analysts participating in the determination of the ESG rating, the identity of the persons who have approved the ESG rating, information as to whether the ESG rating was solicited or unsolicited, and the date on which the ESG rating action was taken; (b) for each ESG rating in the form of a score, the identity of the persons responsible for the development of the rule-based methodology, and the identity of the persons who have approved the rating methodology; (c) the account records relating to fees received from any rated entity or related third party or any user of ratings; (d) the account records for each

subscriber to the ESG ratings; (e) the records documenting the established procedures and rating methodologies used by the ESG rating provider to determine ESG ratings; (f) the internal records and external communications and files, including non-public information and work papers, used to form the basis of any ESG rating decision taken; (g) records of the procedures and measures implemented by the ESG rating provider to comply with this Regulation; (h) the methodology used for the determination of an ESG rating; (i) changes in or deviations from standard procedures and methodologies; (j) all documents relating to any complaint, including those submitted by a complainant.

rating provider's compliance with its obligations under the proposed regulation.

Furthermore, where an ESG rating provider does outsource functions or any services or activities that are relevant for the provision of an ESG rating, it will have to satisfy certain requirements and will remain fully responsible for discharging all of the obligations under the regulation.

Proportionality – SME exemptions

ESMA may exempt small or medium-sized¹⁰ ESG rating providers from some of these requirements (specifically, the general principles) where those requirements are disproportionate in view of the provider's nature, scale and complexity of business, provided that the provider has implemented measures and procedures to ensure the independence of rating analysts and ensure effective compliance with the Proposal's requirements. However, in the case of a group of ESG rating providers, ESMA shall ensure that at least one of the ESG rating providers in the group is not exempted from the requirements.

V. Disclosures

The Commission's approach under the Proposal is centred around increasing the transparency of methodologies for the calculation of ESG ratings rather than to harmonise them.

To ensure transparency, ESG rating providers will be required to disclose information on their website (and through the ESAP) on the methodologies, models and key rating assumptions which they use in their ESG rating activities and in each of their ESG ratings products.

Minimum disclosures to the public:

ESG rating providers would be required to publicly disclose information on the following:

- a. high level overview of the rating methodologies used (and changes

thereto), including whether analysis is backward-looking or forward-looking;

- b. high level overview of data processes (data sources, including if they are public or non-public, and if they are sourced from sustainability statements required by the Corporate Sustainability Reporting Directive (Directive (EU) 2022/2464), estimation of input data in case of unavailability, frequency of data updates);
- c. information on whether and how the methodologies are based on scientific evidence;
- d. information on the ratings' objective, clearly marking whether the rating is assessing risks, impacts or some other dimensions;
- e. the rating's scope – i.e., is it an aggregated rating (aggregating E, S and G factor), or a rating of individual factors or specific issues (e.g., transition risks);
- f. in the case of an aggregated ESG rating, weighting of the three overarching ESG factors categories (e.g., 33% Environment, 33% Social, 33% Governance), and the explanation of the weighting method, including weight per individual E, S and G factors;
- g. within the E, S or G factors, specification of the topics covered by the ESG rating/score, and whether they correspond to the topics from the sustainability reporting standards developed pursuant to Article 29b of the Accounting Directive;

¹⁰ Pursuant to Article 3 of the Accounting Directive, 'small undertakings' are defined as undertakings which, on their balance sheet dates, do not exceed the limits of at least two of the three following criteria: (a) a balance sheet total of EUR 4 000 000; (b) a net turnover of EUR 8 000 000; and (c) an average number of employees during the financial year of 50. 'Medium-sized undertakings' are defined as undertakings

(which are not micro-undertakings or small undertakings), and which, on their balance sheet dates, do not exceed the limits of at least two of the three following criteria: (a) a balance sheet total of EUR 20 000 000; (b) a net turnover or EUR 40 000 000; and (c) an average number of employees during the financial year of 250.

- h. information on whether the rating is expressed in absolute or relative values;
- i. where applicable, reference to the use of Artificial Intelligence in the data collection or rating/scoring process;
- j. general information on criteria used for establishing fees to clients, specifying the various elements taken into consideration, such as the involvement of data analysts, IT equipment, purchasing data;
- k. any limitation in data sources used for the construction of ESG ratings.

Further information would need to be disclosed to the subscribers of ESG rating providers, as well as to rated entities, including a more granular overview of the rating methodologies used and the data processes, an explanation of any AI methodology used in the data collection or rating process, as well as information about engagement with rated entities. Where there is major new information about a rated entity that may affect the result of an ESG rating, ESG rating providers shall disclose how they have taken that information into account and whether they have amended the corresponding ESG rating.

Disclosure of information concerning models should not, however, reveal sensitive business information or impede innovation.

VI. Conflicts of interest and treatment of users

ESG rating providers will be required to ensure that any ESG rating they provide is not affected by any actual or potential conflict of interest, including, in particular, conflicts of interest due to the ESG rating provider's ownership or control or due to other interests in the ESG rating provider's group, or conflicts of interest that are caused by other persons that exercise influence or control over the ESG rating provider in relation to determining the ESG rating.

To that end, the Proposal would impose several requirements on providers:

- to have in place robust governance arrangements, including a clear organisational structure with well-defined, transparent and

consistent roles and responsibilities for all persons involved in the provision of an ESG rating;

- to establish and operate policies, procedures and effective organisational arrangements for the identification, disclosure, prevention, management and mitigation of conflicts of interest;
- to regularly review and update those policies, procedures and arrangements (including a review of operations to identify potential conflicts at least annually);
- to disclose any existing or potential conflicts of interest to ESMA.

The Proposal would also impose requirements regarding the management of potential conflicts of interest from employees (see above).

Where there is a risk of conflict of interest, ESMA may require the provider to mitigate such risk, for example, by establishing an independent oversight function. Where no adequate risk management is possible, ESMA may require the provider to either cease the activities or relationships that create the conflict, or cease to provide ESG ratings.

The Proposal would also require ESG rating providers to ensure that fees charged to clients are fair, reasonable, transparent, non-discriminatory and based on costs.

VII. Supervision and enforcement

The Proposal would entrust ESMA with the exclusive responsibility for authorisation and supervision of ESG rating providers.

ESMA would be able to request any information it requires in its supervisory role, from ESG rating providers, persons involved in ESG rating activities, rated entities and third parties to whom the ESG rating providers have outsourced operational functions and persons otherwise closely and substantially related or connected to ESG rating providers or ESG rating activities. ESMA would also have powers to conduct investigations of such persons as well as on-site inspections (including inspections without prior announcement).

Where ESMA finds an infringement of the regulatory requirements, it may impose various sanctions, including temporary prohibitions on provision or use of the relevant ESG ratings, withdrawal of the relevant provider's authorisation, or imposition of fines (up to 10% of the ESG rating provider's total annual net turnover). ESMA would also have the power to impose periodic penalty payments (of 2% of the daily income / 3% of the daily turnover of the person/entity in question), with a view to promoting the ending of an infringement, provision of information, or submission to an investigation or on-site inspection.

VIII. Next steps

Before the Proposal is adopted and can enter into force, it will need to be discussed and agreed by the European Parliament and the Council of the European Union under the ordinary legislative procedure.

The regulation would then enter into force 20 days after the publication of the regulation in the Official Journal, and its requirements would begin to apply after the relevant transition periods (broadly, 24 months for existing SME ESG rating providers, 12 months for new SME ESG rating providers, and 6 months for all providers that do not qualify as SMEs).

With European Parliament elections to be held in June 2024, it remains to be seen whether completing the legislative procedure before then could be feasible.

IX. Developments in the UK

Like the EU, the UK is developing a regulatory framework for ESG rating providers. In November 2022, as a first step, the FCA announced the formation of a working group to develop a voluntary code of conduct for providers of ESG ratings *and ESG data*.¹¹ This was followed by a consultation, published by HM Treasury in March earlier this year, proposing to bring ESG rating providers within the scope of the UK's financial services regulatory regime.¹²

The table annexed to this memorandum contains a comparison of certain key aspects of the Proposal and the parallel developments in the UK.

...

CLEARY GOTTLIB

¹¹ For a detailed analysis of the FCA's initiative and its potential implications, please refer to the article 'ESG Initiative From FCA Likely To Inform Future Regulation' (Law360), available [here](#) (or on request).

¹² For a detailed analysis of HM Treasury's consultation, please refer to our firm's dedicated alert memorandum, accessible [here](#), and to the article 'Questions Raised By UK Plan For ESG Ratings Providers' (Law360), available [here](#) (or on request).

ANNEX

	UK	EU
Definition of ESG Rating	An assessment regarding one or more ESG factors, whether or not labelled as such, including ‘ratings’, ‘scores’, ‘marks’, etc, including ESG assessments which are directly produced by analysts, as well as assessments which are generated through an algorithm.	An opinion, a score or a combination of both, regarding an entity, a financial instrument, a financial product, or an undertaking’s ESG profile or characteristics or exposure to ESG risks or the impact on people, society and the environment, that are based on an established methodology and defined ranking system of rating categories and that are provided to third parties, irrespective of whether such ESG rating is explicitly labelled as ‘rating’ or ‘ESG score’. Opinion means an assessment that based on a rules-based methodology and defined ranking system of rating categories, involving directly a rating analyst in the rating process or systems process. Score means a measure derived from data, using a rule-based methodology, and based only on a pre-established statistical or algorithmic system or model, without any additional substantial analytical input from an analyst.
Relevance of use to which rating is put	Proposal would capture provision of ESG ratings to a user in the UK <i>where the assessment is used in relation to a ‘specified investment’ under the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.</i>	The scope of the Proposal does not appear to take into account the way in which ESG ratings are used by those to whom they are provided.
Regulation of provision of ESG data	HMT does not currently contemplate regulating the provision of ESG data which involves no, or only minimal, processing, i.e., where no assessment or evolution is being provided. However, the voluntary Code of Conduct that is being developed in the UK would apply to ESG data providers as well.	The Proposal would <i>not</i> capture ESG data that do not include an element of rating or scoring and are not subject to any modelling or analysis resulting in the development of an ESG rating.
Credit ratings	HM Treasury does not intend to capture credit ratings which consider the impact of ESG factors on creditworthiness.	Credit ratings issued pursuant to Regulation (EC) No 1060/2009 of the European Parliament and of the Council are exempted under the Proposal.
ESG ratings for internal uses	HM Treasury does not intend to capture ratings that are created by an entity solely for use by that entity, e.g., asset managers creating their own assessments to inform their investment decisions. NB: HMT is also requesting feedback on whether firms producing ESG assessments	ESG ratings produced by regulated financial undertakings that are used for ‘internal’ purposes are exempted under the Proposal. NB: the Proposal does not clarify whether this includes intra-group ratings.

	to be used by other entities in their group (intra-group ratings) should be regulated.	
Products/services incorporating ESG ratings	HM Treasury does not intend to capture certain specified services such as investment research products, proxy advisor services, and consulting services as well as academic research or journalism.	Products or services that incorporate an element of an ESG rating are exempted under the Proposal.
External reviews	HM Treasury does not intend to capture external reviews, <i>including</i> second-party opinions as well as verifications and certifications of ESG-labelled bonds.	Second-party opinions on sustainability bonds are exempted under the Proposal.
Central banks and public authorities	While HM Treasury has not so far considered whether ESG ratings developed by national authorities/ central banks would be exempted, the Bank of England is already generally exempt from the general prohibition under the Financial Services and Markets Act 2000, and we anticipate that HM Treasury would also exempt it, and other UK and international authorities, as appropriate, from ESG ratings regulation.	ESG ratings produced by central banks that fulfil all of the following conditions are exempted under the Proposal: (a) they are not paid for by the rated entity; (b) they are not disclosed to the public; (c) they are provided in accordance with the principles, standards and procedures which ensure the adequacy, integrity and independence of rating activities, as provided for by this Regulation, and (d) they do not relate to financial instruments issued by the respective central banks' Member States.
Not-for-profit ratings providers	HM Treasury does not intend to capture the provision of ESG assessments by not-for-profit entities (e.g., a UK registered charity or a registered not for-profit entity in another jurisdiction).	While the Proposal does not include a specific exemption for not-for-profit providers of ESG ratings, the definition of 'ESG rating provider' refers to a legal person offering/distributing ESG ratings or scores " <i>on a professional basis</i> ". It remains to be seen whether this would be deemed to exclude not-for-profit entities providing ESG ratings.
Private ratings	HM Treasury intends to capture ESG ratings provided to any user in the UK (subject to the other exemptions listed above).	Private ESG ratings produced pursuant to an individual order and provided exclusively to the person who placed the order and which are not intended for public disclosure or distribution by subscription or other means are exempted under the Proposal.
Territorial scope	HM Treasury proposes to capture, at a minimum, the direct provision of ESG ratings to users in the UK, by both UK firms and overseas firms. Whether firms carrying out these activities would be required to have a physical presence in the UK in order to obtain authorisation is for the FCA to determine and would be subject to full FCA consultation. HM Treasury expects that this determination would be informed by the FCA's existing framework for international firms and based on the nature and scale of	The Proposal covers EU and overseas firms providing ratings to users in the EU (either by way of public disclosure or distribution to regulated financial undertakings, undertakings within scope of Accounting Directive or EU or Member State Public Authorities).

	the firm’s activities, and the risks of harms the activities could cause.	
Indirect provision	HM Treasury has explicitly left open whether it would seek to capture the ‘indirect’ provision of ESG ratings to UK users such as when an ESG ratings provider uses an “issuer-pays” model and the provider, or the rated issuer makes that rating available to UK investors	ESG ratings from an authorised ESG rating provider that are made available to users by a third party are exempted under the Proposal.
Third-country provider regimes	HM Treasury envisages the possibility of an equivalence regime.	The Commission envisages three different regimes (equivalence, endorsement, recognition), depending on the circumstances of the relevant third-country provider.
Regulator	FCA	ESMA
Substantive Obligations	Expected to follow IOSCO recommendations, which focus on: <ul style="list-style-type: none"> • Transparency • Good governance • Conflict-of-interest management • Systems and controls 	The Proposal (reflecting IOSCO’s recommendations) includes: <ul style="list-style-type: none"> • Organisational/governance requirements • Disclosure requirements • Conflict-of-interest requirements
Restriction on ESG ratings providers carrying on other business	No restriction of other business is envisaged in HM Treasury’s proposals.	ESG rating providers would be prohibited from offering a number of other services including consulting services, credit ratings, benchmarks, investment activities, audit, or banking, insurance and reinsurance activities.
Proportionality - small businesses	HM Treasury envisages various options, including (a) requiring all providers to become authorised but subjecting smaller providers to lesser regulatory obligations, or (b) exempting smaller providers from the authorisation requirement (or regulating them in other, bespoke ways).	The Commission proposes a combination of measures to support SMEs: (i) a longer transition period before authorisation would be required (24 months for existing providers and 12 months for new providers, rather than 6 months as for larger undertakings); (ii) supervisory fees would be lower; and (iii) SME providers would be exempt from certain organisational/process requirements. NB: SMEs would <i>not</i> be exempt from the requirement to become authorised.
Transitional periods	<ul style="list-style-type: none"> • 24 months after the date of application of the Proposal for existing ESG rating providers categorized as small and medium-sized undertaking. • 12 months, following notification to ESMA that they intend to provide services, for ESG rating providers categorized as small and medium-sized undertaking that enter 	HM Treasury’s consultation does not include any detail on transition periods.

	<p>the market after the date the Proposal enters into application.</p> <ul style="list-style-type: none">• All other ESG rating providers which provide their services at the date of entry into force of the Proposal must (i) notify ESMA within 3 months if they want to continue offering their services, and (ii) apply for authorisation within 6 months after the date of application of the Proposal.	
--	---	--