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ESG in 3D: ES&G

Code of Conduct for ESG data and ratings providers

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Long live king coal?

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All the pieces of the conduct puzzle: Governance, culture, D&I, innovation

Digest:

- ESG ratings providers are coming under increasing scrutiny over concerns of their reliability in this increasingly vital area
- FCA wants regulatory oversight of certain ESG data and ratings providers
- In the meantime action is being taken to develop a voluntary Code of Conduct
- FS and other industries are encouraged to re-visit their ESG programmes to ensure these are demonstrably authentic to protect their ESG rating
- SEC is developing new rules to combat “greenwashing”

Source/Context:

As financial services firms integrate ESG into their activities and expand ESG-focused products, they are increasingly reliant on third party ESG data and ratings services. ESG providers are coming under increasing scrutiny over concerns of the reliability of their assessments.

The FCA recently expressed their support for introducing regulatory oversight of certain ESG data and ratings providers. The FCA consider that this would support greater transparency and trust in the market for ESG data and ratings services.

If the Treasury extends their regulatory perimeter, the FCA has committed to take the necessary steps to develop and consult on a proportionate and effective regulatory regime, with a focus on outcomes in areas including, transparency, good governance, management of conflicts of interest, and systems and controls.

Whilst the Government considers this the FCA has worked to convene, support and encourage industry participants to develop and follow a voluntary Code of Conduct.

The International Capital Market Association (ICMA) and the International Regulatory Group (IRSG) are to convene an independent group to develop the Code co-chaired by M&G, Moody’s, London Stock Exchange Group and Slaughter and May.

What does this mean for the FS and other industries?

The demand for ESG information and its importance to the industry has increased dramatically in recent years and looks set to continue on an upward trajectory. A recent survey found that 88 percent of investment professionals use third-party ESG ratings as a part of their investment process, with 92 percent expecting to do in future.

This demand for ESG information has in many ways outstripped the ability of suppliers to provide the depth, detail, and accuracy of data required. This could, in part, be due to the immense number of factors that arguably fall under the heading of ESG, the issues with measuring ESG factors, and the challenges of determining their impact. Studies find low correlations across ESG ratings providers.

What does this mean for the FS and other industries?

The growth in importance of ESG ratings to the asset management business is shown by the flow of funds into ESG-labelled products. Bank of America calculates that over $200 billion was invested in ESG bond funds between 2019 and 2022.

The prospect of the regulatory oversight of certain ESG data and ratings providers should encourage the FS and other industries to re-examine their ESG initiatives. Persuading a ratings provider that your approach to ESG is demonstrably authentic could well become significantly more challenging.

In the US, the SEC has warned ratings agencies they are developing new rules to encourage transparency and consistency to help combat “greenwashing”.

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