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Dear Sirs/Madams

Response to ESMA Consultation Paper

Draft regulatory technical standards ("RTS") under the Regulation on the transparency and integrity of Environmental, Social and Governance (ESG) rating activities (the "ESGRR")

1 Introduction

- 1.1 Thank you for the opportunity to respond to the Consultation Paper. We commend ESMA for producing clear and comprehensive draft RTS.
- 1.2 In this response, we comment on all five questions contained in the Consultation Paper.

2 Question 1: Do you agree with ESMA's proposals for the draft technical standards under Articles 6(3) and 12(9)?

2.1 References to articles and parts in this section of the response are to the articles and parts of the draft RTS under Article 6(3) and 12(9) of the ESGRR on authorisation and recognition unless stated otherwise.

Timelines for reporting

2.2 The information required to be submitted by ESG rating providers pursuant to the draft RTS on authorisation and recognition is extensive and ESG rating providers may struggle to obtain, consider and provide to ESMA the required information in advance of the relevant ESGRR deadline. We consider ESG rating providers may benefit from a short extension to the window for applications, from 2 November 2026 (Article 51(1) of the ESGRR) to at least 2 January 2027.

Further guidance

2.3 There are a number of areas in the draft RTS on authorisation and recognition which ESG ratings providers may benefit from further guidance. We set out some areas of particular concern below.

2.4 Article 6(5) of the ESGRR provides "*ESG rating providers shall notify ESMA of any material changes to the circumstances under which the initial authorisation was granted, including any opening or closing of a branch within the Union, without undue delay*". ESG rating providers may benefit from further guidance in respect of the meaning of the term "*material changes*" in Article 6(5) of the ESGRR. Recital 30 of the ESGRR also notes that ESG rating providers may benefit from such guidance: "*In order to provide more clarity to ESG rating providers, ESMA should specify what constitutes a material change by issuing guidelines to that effect*". Further, ESG rating providers may also benefit from further guidance on best practice in terms of what constitutes "*undue delay*", i.e. whether ESG rating providers should update ESMA within a certain short period in respect of specific changes, or (perhaps more proportionately) ESMA could be updated annually or bi-annually of changes that do not require urgent updates.

2.5 One example of where this guidance would be particularly helpful is in relation to the requirements to provide staffing details. As an ESG rating provider may have a significant number of staff, who may leave at different times, the requirement to provide staffing details could be unduly burdensome to make multiple changes where only one member of staff changes.

2.6 Part H(1) of Annex II requires ESG rating providers to state the number of ESG rating products the applicant intends to provide in the EU. For each ESG product, Part H(2)(c) of Annex II requires ESG rating providers to set out the "*geographical markets in which the product will be offered, specifying whether it will be offered Union-wide or in selected Member States and the expected number of rated items, issuers or issuers of rated items on a member state by member state basis, where applicable*". ESG rating providers may benefit from further guidance in respect of the meaning of the term "*expected number of rated items*", e.g. whether ESMA recommends ESG rating providers use specific methodologies or a range is sufficient to calculate the expected number of rated items offered in a geographical market.

2.7 Part I)(1)(b) of Annex II requires ESG rating providers to provide "*for each ESG rating product listed in Part H, the description of applicable procedures and methodologies, models and key rating assumptions to issue ESG ratings, including information on:... whether the applicant expects to use*

methodologies that are based on scientific evidence and takes into account the targets and objectives of the Paris Agreement or any other relevant international agreements". Recital 34 of the ESGRR provides some clarity in respect of the meaning of the term "*other relevant international agreements*".¹ Notwithstanding the guidance contained in Recital 34 of the ESGRR, ESG rating providers may benefit from further guidance in respect of the meaning of "*other relevant international agreements*", e.g. does ESMA intend for voluntary standards such as OECD Guidelines, GRI and ISSB to be caught by this provision, are ESG rating providers responsible for deciding what other international standards are relevant, or does ESMA intend only for binding agreements between Member States to be caught by this provision?

- (a) Where applicable, Part K of Annex II requires ESG rating providers to provide "*documents and information related to any existing or planned outsourcing*". ESG rating providers may benefit from guidance in respect of how certain planned outsourcing needs to be before it becomes disclosable to ESMA as part of an application for authorisation or recognition.
- (b) Where applicable, Part L of Annex II requires ESG rating providers to provide "*the name and description of any other business activities carried out by the applicant, or which the applicant intends to carry out*". Again, ESG rating providers may benefit from guidance on how certain "*intentions*" in respect of carrying out other business activities need to be to meet the threshold for reporting.

3 Question 2: Do you agree with ESMA's proposals for the draft technical standard under Article 16(5)?

- 3.1 References to articles in this section of the response are to the articles of the draft RTS under Article 16(5) of the ESGRR on separation of activities unless stated otherwise.

Separation of activities

- 3.2 The requirements in the draft RTS on separation of activities may result in significant and costly organisational changes for ESG rating providers. For example:
 - (a) Article 1(1)(a) requires ESG rating providers offering the services listed in Article 16(1) of the ESGRR to "*put in place design-making procedures and organisational structures which specify reporting lines and allocate functions and responsibilities in a manner that ensures that employees directly involved in the assessment process of a rated item are not involved in the activities referred to in Article 16(1) of [the ESGRR]*".
 - (b) Article 1(1)(b) requires ESG rating providers offering the services listed in Article 16(1) of the ESGRR to "*implement physical separation measures that provide for a segregated office space and secure access for employees and other persons directly involved in the assessment process of a rated item*".
- 3.3 These requirements may cause ESG rating providers to incur substantial costs in making changes to reporting lines and establishing separate office spaces for employees directly involved in the assessment processes of a rated item. This concern regarding costs is acknowledged by ESMA in the cost benefit analysis contained in the Annex I of the draft RTS. However, it is unclear whether ESMA has considered that certain steps may have a disproportionate effect on certain ESG rating providers.

¹ "[T]he targets and objectives of relevant international agreements, including those of the Paris Agreement adopted under the United Nations Framework Convention on Climate Change (the 'Paris Agreement') approved by the Union on 5 October 2016 for the E factor, compliance with the International Labour Organisation's core conventions on the right to organise and collective bargaining for the S factor, and alignment with international standards on tax evasion and avoidance for the G factor."

One alternative might be to allow ESG rating providers who are able to provide a sufficient explanation as to why this would be a disproportionate step in their particular circumstances to make the case for reliance on an enhanced package of non-physical separation measures, such as information barriers and regular training, as an alternative. Further, we consider ESG rating providers may benefit from further guidance on whether transitional measures are acceptable to ESMA while more substantial physical separation measures are being implemented, accompanied by an explanation from the ESG rating provider setting out why transitional measures are needed and by which date physical separation measures will be in place.

- 3.4 Separately, Article 2(1)(d) requires ESG rating providers engaging in investment, credit, insurance and benchmark services to “*implement... within the organisation and, where applicable, at group level:... regular training of employees on the importance of information barriers*”. ESG rating providers caught by this provision may benefit from further guidance in respect of how frequently such training should occur, i.e. bi-annually, annually or every two years (and whether this should, for example, be varied depending on the levels of understanding demonstrated following completion).

4 Question 3: Do you agree with ESMA’s proposals for the draft technical standards under Articles 23(4) and 24(3)?

- 4.1 References to articles in this section of the response are to the articles of the draft RTS under Article 23(4) and 24(3) of the ESGRR on disclosure unless stated otherwise.

Entities applying for exemptions

- 4.2 In order to qualify for certain exemptions under the ESGRR (for example the regulated products and services exclusion under Article 2(2)(c) of the ESGRR), ESG rating providers are required to make additional disclosures under Annex III of the ESGRR. However, entities relying on these exemptions do not appear to be addressed in the draft RTS on disclosure. Given the draft RTS disclosure requirements are additional to rather than an elaboration on the disclosure requirements contained in Annex III of the ESGRR,² and ESMA’s mandate for the draft RTS on disclosure requirements stems from Articles 23(4) and 24(3) of the ESGRR rather than Annex III of the ESGRR, it appears that the draft RTS on disclosure requirements are not relevant to entities relying on exemptions requiring additional disclosure. However, please can ESMA confirm whether this is the case.

Meaning of “other international agreements”

- 4.3 Article 3(3)(a) of the draft RTS refers to “*other international agreements [which] are taken into account, with reference to basic identifying information on these agreements together with an explanation of their relevance to the rating*”. See our comments at paragraph 2.7 above in respect of Part I(1)(b) of Annex II of the draft RTS.

Transparency re how complaints are reflected in the methodology

- 4.4 We consider ESG rating providers may benefit from further guidance in respect of how complaints made against entities being rated interact with the provisions in the draft RTS on the disclosure of methodologies, e.g. if a complaint is made against an entity being rated by an ESG rating provider, does ESMA intend for such complaints to be disclosed as a limitation under Article 5? Does ESMA require any caveats to be put on ratings where complaints are outstanding, under investigation or withheld, or is it up to the ESG rating providers to decide how to deal with this issue within their own

² Paragraphs 29 to 30 of the Consultation Paper.

methodology? ESG rating providers may benefit from further clarity in respect of the interaction between complaints made against entities being rated and the disclosure obligations contained in the draft RTS.³

Disclosure of limitations

4.5 Article 5 requires ESG rating providers to disclose any limitations in data sources, methodologies and information. ESG rating providers may benefit from guidance on what sort of limitations must be disclosed, e.g. does ESMA only intend for known limitations identified while designing the methodologies to be disclosed? Further clarity in respect of the extent of self-evaluation ESMA expects from ESG rating providers would aid compliance by ESG rating providers with the draft RTS. We recommend replacing Article 5 as currently drafted with the following to aid compliance by ESG rating providers with the draft RTS:

(a) *“As part of the information disclosed in accordance with Annex III, point 1, letters (m) and (q), of Regulation (EU) 2024/3005, ESG rating providers shall explain any limitations known at the time the disclosure is made to ESMA, in respect of the following:...”.*

5 Question 4: Do you consider that the draft RTS under Articles 23(4) and 24(3) should instead provide an expanded table in Annex I proposing a sequence and structure for all disclosures to be made under Parts 1 and 2 of Annex III of the draft RTS? If yes, please explain the benefits of such an approach.

5.1 Table 1 is very useful given how extensive the disclosure obligations in the draft RTS are. The draft RTS need to be read carefully by ESG rating providers in combination with the ESGRR to ensure all disclosures are made in a compliant manner. The draft RTS helpfully suggest a common sequence for disclosures under Part 1 of Annex III of the ESGRR, but not Part 2. ESG rating providers may find this confusing, so we consider it would be helpful for ESMA to provide an expanded table proposing a sequence and structure for all disclosures to be made under Annex III of the ESGRR so that ESG rating providers have a single reference point for disclosure obligations.

5.2 Articles 23(5) and 24(4) of the ESGRR state that ESMA may develop draft implementing standards to specify the data standards, formats and templates that ESG rating providers are to use to present the information referred to in those provisions. ESG rating providers may benefit from guidance as to how and in what format to present disclosures required by Articles 23 and 24 of the ESGRR.

6 Do you agree with ESMA’s proposed cost-benefit analysis? If not, please explain.

Streamlining the draft RTS

6.1 Aligning the empowerments under Articles 6(3) and 12(9) of the ESGRR into a single-draft RTS covering both authorisation and recognition simplifies the draft RTS for ESG rating providers, thereby reducing costs associated with compliance efforts. We endorse ESMA’s approach in this regard.

6.2 In respect of the draft RTS on disclosure, we suggest that Table 1 (set out in the Annex to the draft RTS on disclosure) should also include disclosures made under Part 2 of Annex III of the ESGRR to

³ For example, the World Benchmarking Alliance’s Corporate Human Rights Benchmark takes complaints into account in its methodologies.

simplify further the draft RTS on disclosure, thereby reducing compliance costs for ESG rating providers.

Costs of physical separation – recognising differing circumstances

6.3 In respect of the draft RTS on separation of activities, requirements in respect of physical separation of office space and changes to reporting lines are significant. ESMA may consider whether lower-cost alternatives such as information barriers and regular training could be sufficient in certain circumstances, especially for small-to-medium ESG rating providers, or whether requirements in respect of separation of activities can be delayed/phased in (see our comments at paragraph 3.3 above in respect of Article 1(1)(b) of the draft RTS).

We hope that our submissions are helpful and well received, and we welcome any questions arising therefrom.

We look forward to reviewing the finalised RTS.

Yours faithfully

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