

EFAMA Brief - 2022

The Future of ESG Ratings and Their Role in Investment Decisions (esg)

The investment management industry is working on enhancing Environmental, Social, and Governance (ESG) disclosures as a response to the increasing demand for ESG-focused article and funds. However, the industry faces challenges due to the lack of harmonized and publicly available ESG disclosures. The ESG ratings market should be transparent and competitive to function well in the future.

Studies show that there are differences in ratings assigned by different commercial providers such as Refinitiv and Morningstar, indicating the need for a consistent methodology and regulatory framework for ESG ratings. Recommendations include avoiding reliance solely on ESG ratings or fund type when advising clients, using additional verification tools like the European ESG template and consulting services, and developing an EU regulatory framework for ESG ratings to ensure fair competition, transparency, and prevention of conflicts of interest. The ongoing growth of ESG funds indicates that the use of ESG ratings will continue to increase. For effective usage, ESG rating methodologies need to align with both the Sustainability Financial Disclosure Regulation (SFDR) classification and individual investors' ESG preferences. ESG measures should, therefore, not be solely relied upon when advising retail investors.

EFAMA's Membership in EFRAG: Driving Sustainable Finance and Reliable Reporting Standards (sustainability)

The European Fund and Asset Management Association (EFAMA) is delighted to join the European Financial Reporting Advisory Group (EFRAG). EFAMA highlighted the crucial role of EFRAG in crafting dependable, consistent, and comparable sustainability reporting standards across the EU and the potential impact on international sustainability disclosures. The imminent reporting standards are expected to bridge the current data gap and stimulate the sustainable finance sector to realize its maximum capacity. EFAMA's involvement in EFRAG's sustainability reporting mechanisms guarantees that such disclosures align with investors' needs regarding companies and products' sustainability profiles. EFAMA fully supports the accelerated timeline set by the European Commission and anticipates collaborative work on the vital EU sustainability reporting standards. This interest was sparked by the expanding ESG ratings market and increasing demands for sustainable funds. Recent legislative developments, such as the adoption of the Corporate Sustainability Reporting Directive (CSRD) and the initiation of European Sustainability Reporting Standards (ESRS), are crucial steps in overcoming data scarcity in ESG, which has been a primary barrier in actualizing the EU's sustainable finance regulation potential.

Analysis and Future Recommendations on ESG Ratings Market (esg ratings)

The newly released study by EFAMA dwells on the evolving ESG ratings market in line with the growing demand for article and funds, which are new ESG-related fund categories developed by Sustainability Financial Disclosure Regulation (SFDR). The study benchmarks ESG ratings provided by commercial providers - Refinitiv and Morningstar Direct - across

multiple funds and indicates variations among the ratings provided by these firms. Presenting policy recommendations, they suggest the creation of an EU regulatory framework which imposes disclosure of methodologies and data sources, ensures an even playing field for firms assigning ratings, sets specific requirement for internal controls and governance to avoid conflicts of interest. To maintain a competitive market, the pricing and licensing frameworks should be well-understood by the supervisory authorities to prevent outrageous charges by a handful of providers. Positive correlation between ESG ratings of Refinitiv and Morningstar Direct, albeit small, was also highlighted. This analysis is deemed timely as the EU commission is considering regulatory framework for ESG ratings which will ensure market transparency and competitiveness that aligns with Europe's transition to a climate-neutral economy.

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