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Code of Conduct for ESG data and ratings providers – bridging the authenticity gap

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The clamour for greater authenticity is palpable and it is growing.

The FCA recently expressed their support for introducing regulatory oversight of certain ESG data and ratings providers. The regulator considers 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 is committed to taking 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 a magic circle law firm.

The demand for ESG information and its importance to the industry has increased immensely in recent years and remains 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.

The prodigious and increasing appetite 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 vast number of factors that arguably fall under the heading of ESG, the issues with measuring ESG factors, and the challenge of determining their impact.

Studies have found low correlations across ESG ratings providers.

The current lack of coherence and consistency in ESG data is frequently baffling to the point of being meaningless and risks bringing ESG data and ratings providers into serous disrepute. ESG itself risks being tainted by association.

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 services providers should encourage the FS and other industries to re-examine their ESG initiatives to prepare for more transparency.

Demonstrating to ESG data and ratings providers that their organisation merits that essential top ESG rating looks set to become more challenging for some, but increased authenticity on ESG has to be in the best interests of all.

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

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