

## **Terms of Reference**

### **ESG Data and Ratings Code of Conduct Working Group (DRWG) – Development of a globally consistent voluntary Code of Conduct for ESG data and ratings providers that fosters an effective, trusted and transparent market**

#### **Background**

In June 2022, the FCA published a Feedback Statement ([FS22/4](#)) bringing together the feedback received to [CP21/18](#)'s discussion chapter. This discussion chapter covered two active areas of debate in capital markets – one of these being the role and regulatory oversight of ESG data and ratings providers.

In the Feedback Statement, the FCA noted that it does not consider the different judgements reached by ESG ratings and rating-like products providers inherently to be a source of harm, as long as the providers:

- are transparent about their methodology, information, and data inputs
- determine their outputs by applying systematic processes, and sound systems and controls
- identify, manage, and disclose conflicts of interest
- operate with robust governance

These conditions are equally applicable to many value-added ESG data products, especially where the provider exercises judgement. However, some of these conditions may not be fully met in practice, thereby potentially causing harm. These risks are also further exacerbated as firms often embed ESG data and ratings products into their investment processes, thereby influencing capital allocation decisions.

The FCA therefore set out in FS22/4 its policy actions and potential future direction. Importantly, the FCA mentioned seeing a clear rationale for regulation of certain ESG data and ratings providers, and for a globally consistent regulatory approach informed by [IOSCO's recommendations](#) on ESG data and ratings.

The Government is [currently considering](#) whether to bring ESG data and ratings providers within the FCA's regulatory perimeter. However, should the Government decide to do so, setting up a new regulatory regime would take time. Considering the potential for harm identified in this market, the FCA has therefore decided to convene and support an industry-led group to develop and follow a voluntary Code of Conduct for ESG data and ratings providers.

#### **Target outcomes**

The timely development of a voluntary Code of Conduct for ESG data and ratings providers is expected to (i) help build trust in the market, (ii) protect market integrity, and (iii) promote effective competition.

As industry participants more fully integrate ESG into their activities and expand their ESG-focussed product offerings, they are increasingly reliant on and embedding within their investment processes third-party ESG data and ratings services. However, as highlighted in the FCA's [FS22/4](#), some industry participants have concerns on the transparency, quality and reliability of ESG data and ratings products, and therefore support closer regulatory scrutiny of ESG data and ratings providers – ideally through a globally consistent approach.

The development of a globally consistent voluntary Code of Conduct would represent an important step towards addressing these concerns and building trust. By establishing

best practices on transparency, governance, systems and controls, and management of conflicts of interest, the Code could (i) improve the availability and quality of information provided to investors at product and entity levels, (ii) enhance market integrity through increased transparency, good governance and sound controls, and (iii) improve competition through better comparability of products and providers. Eventually, the Code could inform potential future regulation, with a view to ensure a globally consistent approach.

### Objectives of the DRWG

The FCA has convened the Secretariat that will appoint and lead the **ESG Data and Ratings Code of Conduct Working Group (DRWG)** – an industry working group with a mandate to develop a voluntary Code of Conduct for ESG data and ratings providers.

By bringing together the views and expertise of all key stakeholder groups within the ESG data ecosystem, and with the support of an experienced and independent Secretariat, the DRWG will be well-placed to develop a comprehensive, proportionate and globally consistent voluntary Code of Conduct.

The DRWG has the following objectives:

- **Develop a globally consistent voluntary Code of Conduct for ESG data and ratings providers.** In doing so, the DRWG should:
  - o Ensure the Code sets out clear, comprehensive and proportionate guidance for ESG data and ratings providers, while taking into account the needs of all key stakeholder groups within the ESG data ecosystem - including the entities that are the subject of ESG data and ratings products/services, and the users of these products/services.
  - o Use the detailed content of [IOSCO’s recommendations](#) and the proposed four key outcomes set out in Figure 1 as the Code’s baseline, building on and elaborating their content where appropriate.

*Figure 1: Proposed key outcomes (based on IOSCO’s recommendations)*

Transparency	Good governance	Management of conflicts of interest	Robust systems and controls
<ul style="list-style-type: none"> <li>• Methodologies (incl. individual underlying components, measurement objective)</li> <li>• Data and information sources (incl. whether public)</li> <li>• Procedures for data gaps, and the use of averages and estimates</li> </ul>	<ul style="list-style-type: none"> <li>• Enabling good management of conflicts of interest</li> <li>• Internal consistency of methodology within a provider</li> <li>• Sufficient resources and competent personnel</li> </ul>	<ul style="list-style-type: none"> <li>• Identification, mitigation, management and disclosure of conflicts of interest</li> </ul>	<ul style="list-style-type: none"> <li>• Written policies and procedures and/or internal controls on processes and methodologies</li> <li>• Facilities for reporting of complaints and misconduct (incl. on independence, transparency and integrity)</li> <li>• Engagement with rated entities</li> </ul>

- o Take note of relevant regulatory initiatives internationally, such as Japan’s [draft Code of Conduct](#).
- o Where relevant, promote market convergence towards well-understood and recognised definitions.
- Consider how the Code should be periodically reviewed so that it continues to reflect best practices and to meet market participants’ expectations, and the most

appropriate mechanisms to ensure that compliance with the Code is meaningful and proportionate.

## **Guidelines**

When developing the voluntary Code of Conduct for ESG data and ratings providers, the DRWG should adhere to the following guidelines:

- The Code of Conduct should include a comprehensive, proportionate and ambitious set of best practices for ESG data and ratings providers aimed at promoting and safeguarding the trust of all relevant market participants – including the users and rated entities – in both the providers and their products/services.
- The Code of Conduct should promote global consistency. It should therefore be grounded in [IOSCO's recommendations](#) on ESG data and ratings provision, published in November 2021, and be structured around the following four outcomes:
  1. Transparency
  2. Good governance
  3. Robust systems and controls
  4. Sound management of conflicts of interest
- To further ensure global consistency, other relevant regulatory initiatives – such as Japan's [draft Code of Conduct](#) for ESG evaluation and data providers, and relevant ongoing developments in the European Union – should be considered.
- When drafting the Code, the DRWG should also have regard to:
  - o The breadth of ESG data and ratings products/services, as well as relevant commonalities and differences across those
  - o How – and by whom – these products/services are used in the market, including where they inform other financial products/services
  - o The different sizes and capabilities of ESG data and ratings providers, but also of the rated entities and users of these products/services
  - o Providers' relationships with both the entities that are the subject of ESG data and ratings products/services (e.g., rated entities) and the users of these products/services
- Finally, the DRWG should consider how to encourage the wide adoption of the Code across ESG data and ratings providers, and how to promote awareness of the Code amongst rated entities and users of these products/services.

## **Membership**

### *Secretariat*

The Secretariat role will be jointly fulfilled by the International Regulatory Strategy Group (IRSG) and the International Capital Market Association (ICMA) to ensure an unbiased and balanced representation of all key stakeholder groups. The Secretariat will appoint the members of the DRWG, offer an in-depth understanding of both the UK and global financial markets, and help facilitate access to legal support where necessary.

### *Working group (DRWG)*

The DRWG will be led by two suitably independent and knowledgeable chairs and two vice-chairs; one chair and vice-chair nominated by IRSG and ICMA respectively. The members of the DRWG (16-18 members excl. chairs and vice-chairs) will represent the following key stakeholder groups within the ESG data ecosystem, and will be selected by

ICMA and IRSG according to the DRWG's requirements and taking into account the need to establish as broad a range of stakeholder views as possible:

- primary sources of data and rated entities (eg, corporates) [circa. 4 members]
- large and small ESG data & ratings providers [circa. 5 members]
- asset managers, asset owners and other wholesale market users of ESG data and ratings [circa. 6 members]
- experts from academia, NGOs and other relevant organisations [circa. 3 members]

Members will be expected to consistently participate and contribute to the discussion and writing of the Code. The chairs supported by the Secretariat will be there to guide the agenda, meetings and aim of the DRWG; where necessary help find a consensus, and help the DRWG adhere to the timeline and deliver outcomes including a consultation in the first half of 2023.

Throughout the process, the FCA, His Majesty's Treasury, the Bank of England, the Financial Reporting Council, and other relevant financial regulators and government departments will be active observers, offering their views where deemed appropriate.

### *Sub-groups*

The DRWG may establish sub-groups, reporting to the main DRWG, to investigate or work on specific issues.

### **Engagement**

In the course of the DRWG's work, the chairs and vice-chairs will accept informal feedback and proactive comments from all relevant stakeholder groups operating within the ESG data ecosystem. In parallel, and where necessary, the DRWG will engage in outreach and seek wider industry feedback, potentially through representative bodies facilitation.

### **Indicative timeline and deliverables**

The DRWG should seek to publish a draft of the voluntary Code of Conduct for consultation approximately within 6 months of the first meeting, and the final version of the Code within approximately 4 months of the start of the consultation.

The DRWG should set out its recommendation on the ownership of the Code – the body responsible for hosting and maintaining the Code, as appropriate – when the final version of the Code is published – at the latest.

### **Frequency of meetings**

The DRWG will meet on at least a monthly basis to write the Code and discuss progress. Any sub-groups will define their own schedule of meetings such that they can meet the timeline set by the main DRWG.

### **Interaction with the FCA**

While the FCA has convened the Secretariat of the DRWG and written these Terms of Reference, the development of the voluntary Code of Conduct will remain industry-led and -owned. The DRWG will report to the FCA once a draft Code of Conduct has been written, and indicate where points of contention, if any, have arisen.

Alongside this, the FCA will consider throughout the drafting process of the Code what support can be provided to the DRWG.

The FCA reserves the right to dissolve the DRWG at any time, and will do so once the objectives of the DRWG have been achieved. In these circumstances, the FCA will consider how to take forward any outputs from the DRWG, as appropriate.

### **Confidentiality**

Meetings will be conducted under the Chatham House rule, such that comments, dialogue and feedback within the DRWG's meetings will not be attributable to individuals or the organisations they represent or with which they are associated. The Chatham House rule will also apply in any situation where a formal conversation occurs relating to the work of the DRWG.

As noted in the 'Engagement' section of this terms of reference, discussion of the work of the DRWG is encouraged for the purposes of facilitating industry engagement and gathering feedback.

Should it prove necessary to share information with the DRWG to achieve the aims of the group, members of the DRWG will do so in compliance with applicable competition laws. Further, members will undertake not to disclose any information which is confidential in nature, or which is provided in confidence, without authorisation.

It is understood that DRWG members may want to discuss the group's material within their organisations. In doing so, DRWG members are expected to accept responsibility for ensuring that any persons they discuss the work and materials with are aware of and respect the confidentiality and sensitivity attached to the work and materials of the DRWG. Trade associations and other representative bodies will be able to ask their membership for general views on topics relevant to the work of the DRWG, but will refrain from sharing any of the DRWG's material with their membership.

### **Competition law and other relevant laws**

All actions of the Working Group and sub-groups will be governed by the following competition statement, which will be read out at meetings on a regular basis by the Secretariat:

Participants in the Working Group and sub-groups are reminded of their obligations under competition law. These include not disclosing any commercially sensitive information to competitors. The disclosure of commercially sensitive information may amount to a breach of competition law. Please note that it is the responsibility of each participant to take their own legal advice on competition law and to ensure their and their representatives' compliance.

### **Governance**

As described above, the objectives of the DRWG are to develop (i) a comprehensive, proportionate and globally consistent voluntary Code of Conduct for ESG data and ratings providers, and (ii) a recommendation on ownership of the Code. Where individual members of the DRWG offer conflicting points of view and opinions, the chairs and vice-chairs supported by the Secretariat will endeavour to make recommendations that represent the consensus of the DRWG and to fairly consider the opinions of all represented stakeholder groups. In situations where a consensus cannot be reached, the chairs and vice-chairs will make the recommendation of the majority, but will capture dissenting points within the meeting minutes.

Active observers will not submit formal views but will participate in discussions. The DRWG's recommendations will not bind its members.