Comment

of the German Insurance Association (GDV)
ID-number 6437280268-55

on the
ESMA Call for evidence on Market Characteristics for ESG Rating Providers in the EU

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Zertifikat seit 2014
audit berufundfamilie

GDV answers within the ESMA online questionnaire:

6.2 Questionnaire B for Users of ESG Rating Providers

6.2.1 Background information

Q1: Name of respondent or organisation (including Legal Entity Identifier).

German insurance association (GDV), Berlin, Germany

Q2: Nature of establishment in EU

(A) Legal entity established in EU
Please indicate Member State(s) of legal entities

Germany

Q3: Respondent subject to any existing financial regulatory authorisation, registration or supervisory regime.

Yes

Please provide further details of regime including name of authorisation, registration, or supervisory body and reference to supporting legal acts.

We answer this questionnaire as the German insurance association (GDV). Our more than 450 members are representing over 95% of the insurance market in Germany with total investments of 1.75 trillion EUR.

Regulatory authorisation of our members: German Federal Financial Supervisory Authority (BaFin) Supervisory regime: European System of Financial Supervision; BaFin, German Federal Bank etc.

Legal acts (i. a.): Solvency II, Insurance Supervisory Law (VAG)

Q4: General description of business model and main area of economic activity.

Life-Insurance Companies, Non-Life Insurers and Health Insurers, Reinsurers

Q5: Estimated total value (in EUR) of administrated assets and/or asset under management (if applicable).

No answer.

Q6: Estimated total value (in EUR) of investments for which ESG rating and/or other ESG data products are used as input in investment decision making process (if applicable).

No answer.

6.2.2 Use of ESG ratings (if applicable)

Q1: Currently contracting for ESG ratings

Yes

Q2: Currently contracting for other ESG data products

Yes

Q3: If yes to Q1 or Q2, please list the providers you contract with for each ESG rating and/or other ESG data products and identify the categories of product.

Our members have contracts with different providers of ESG ratings. This is particularly the case with the well-known major providers.

Q4: Please provide the length of time in months which you have contracted with each provider.

Most members mentioned between 12 and 36 months.

Q5: Please explain reason behind the choice of the ESG rating or data provider(s) listed in Q3.

Various reasons to choose a specific provider, e.g.:

- data coverage
- data interface,
- analysis: CO_2, TCFD, impact, risk assessments
- functionalities in reporting
- Norm-based screening for definition of exclusion criteria

- Climate data for the individual climate strategy
- Fulfillment of regulatory requirements of the Taxonomy and Disclosure Regulation

Q6: Please explain reason for choosing more than one ESG rating provider (if applicable).

No answer.

Q7: In case you changed ESG rating provider, please provide the rationale behind the choice.

No answer.

Q8: Please outline and explain any shortcomings in the ESG rating or ESG data products you currently contract for.

Main shortcomings:

- Climate data for SFDR and taxonomy are often based on estimates, as reliable firm-level data are not available.
- Data coverage is not sufficient (especially in regard with illiquid assets).
- Methodologies, definitions and processes used by providers often not clear and transparent enough.
- Insufficient and unclear regulatory specifications hinder the collection or mapping of data by the data provider. However, insurers are observing constant efforts by data providers to gradually meet their requirements.

Q9: Please outline whether you are satisfied with the level of methodological transparency for the products you contract for, including transparency around data sourcing.

The level of methodological transparency is often seen as not sufficient enough. In particular, the fact that the accuracy of the data itself cannot be assessed is viewed critically.

Q10: If no to Q1 and Q2, please list ESG rating and/or other ESG data products providers you are currently using.

No answer.

Q11: Please outline and explain any shortcomings in the ESG rating or ESG data products you are currently using on a non-contractual basis.

No answer.

Q12: Please outline whether you are satisfied with the level of methodological transparency for the products are currently using on a non-contractual basis.

No answer.

6.2.3 Contractual Characteristics

Q1: If you currently contract for ESG rating or ESG data products, please briefly describe the terms of use of your ESG rating provider, including:

(A) Time horizon of the contract
Please provide details of break clauses and frequency of renewal.

Different time horizons amongst members:
- Annual
- Initial 1-year period with triennial renewals and discounts for longer periods.

But: Discounts are equalized and quickly overcompensated by annual price increases.

(B) Products included in contract
Please outline if the contract covers a single product offering or a package of product offerings.

The contracts include various product packages (different modules).

Please outline if products were available only under the form of packages of multiple service and/or products.

Different packages of data fields are offered, each of which can be licensed separately.

Please provide a more specific description of the products including their intended area of focus.

Examples of products used by our members:

- ESG Ratings
- Business Involvement Screening
- Norms & Controversies Screening
- EU Taxonomy Alignment Solution
- Climate Change Metrics
- Climate Value at Risk
- Climate Lab
- Norm-Based Research
- Sovereign/Country NBR
- Controversial Weapons
- Sector-Based Screening
- Energy and Extractives Data
- Climate Impact Data
- Climate Sovereign Emissions (DataDesk Data Set)
- SFDR Principle Adverse Impact Solution

The purchase of product packages depends on the regulatory requirements, e.g. SFDR, Taxonomy, MIFID II, IDD or CSRD as well as on the requirements of the internal ESG-strategy.

(C) The Fees structure for contracted products
Please outline if there is a flat fee for each product offering, or discount for bundled offerings.

Usually there are discounts for bundled offerings. Fees are negotiable to a certain extent. But discounts for multi-year contracts are often equalized and later on overcompensated by annual price increases.

Please outline the main characteristics of the fee structure, including frequency and transparency of revisions.

No answer.

(D) Any usage limitations (e.g. use of ratings, access to ESG ratings, time restrictions, others).
Please outline if there are any usage limitations placed on the products which are contracted for, for example, ability to disclose or share with third parties.

The intended use is negotiated and documented as part of the conclusion of the contract. The products may not be passed on to third parties.

6.2.4 General views on ESG ratings in EU Financial Markets

Q1. Please provide your views on the level of relevance of ESG ratings to EU financial markets and financial market participants. Do you consider this level will increase in the coming years?

The need for ESG ratings and -data has increased significantly in recent years due to new regulatory requirements and will further increase as regulatory requirements continue to grow. As a result, insurers are forced to purchase more and more modules from ESG data providers. Another reason for the growing importance is the increasing sustainability-related focus of many companies. In the future, the focus is likely to be less on holistic valuations of companies and more on data deliveries for regulatory or internal ESG requirements.

With regard to ESG ratings in the EU financial markets, we are critical of the fact that the need for comparability, the broad coverage of ESG ratings and the resource- and skill-intensive nature of sustainability research and ratings have already led and will continue to lead to a high degree of concentration in this market. As a result, providers are evolving into oligopolistic structures, with the cost of accessing ESG ratings/data increasing and freedom of choice in terms of providers decreasing.

While prices for the products increase every year significantly, at the same time it is hardly possible for companies to change data providers, as the conversion of already established calculations and processes would involve a considerable organizational effort that is not affordable. A change of data provider is also likely to result in significant changes to the assessments and composition of the total portfolio due to the lack of comparability of ESG ratings. Overall, insurers see the same dependency in ESG ratings and -data that is already familiar from credit ratings. Data providers exploit this dependency and dictate prices accordingly.

A certain level of EU regulation of ESG assessment providers is needed to address the aforementioned problems with ESG ratings and data providers such as lack of transparency, comparability, oligopolistic structures/market power and rising costs. From a user perspective, EU initiatives should aim to reduce costs and avoid forcing market participants to rely on third-party providers. In addition, efforts should be made to improve the comparability and reliability of studies and ratings, which are currently problematic due to differences in definitions, data sources, methods, and frequency of data collection. Oligopolistic structures, similar to those of traditional rating agencies, must be avoided in the interest of diversity and appropriate pricing.

In this context, the EU legislative proposal for a European Single Access Point (ESAP) is very welcome and crucial to reduce dependency on data providers and their market power. Without ESAP, the various new EU regulations on sustainable finance and related industry requirements will further increase the cost of accessing ESG data. In addition, ESAP could also be helpful to better understand ratings (if ESG ratings are based on data available in ESAP) and also provide some quality control.

However, a strong level of rating and data comparability can only be achieved on a global level. Therefore, EU regulatory initiatives on ESG ratings should be closely aligned with global initiatives such as the ISSB Global Baseline or with IOSCOs set of recommendations from November 2021. In terms of supervision of ESG assessment-providers at EU level, ESMA is considered the suitable authority.

Overall, there are number of considerations to be made in developing an EU regulatory initiative, such as the role of existing EU sustainability regulations (such as PAI under the SFDR or DNSH under the Taxonomy Regulation) and the potential impact of different rating approaches for EU and non-EU companies to avoid an uneven playing field.

As a first step (global) minimum disclosure/transparency requirements for ESG ratings and data product providers (on definitions, data sources, methodologies, processes, etc.) should be introduced since improvements in transparency would already mitigate – to a large extent – related challenges (comparability, significant costs for insights into rating requirements and resulting uneven playing field, etc.).

For rated companies, the current landscape of significantly differing ESG ratings leads to key challenges such as 1) very resource intensive response processes to many, often not comparable, ratings in an effort to confirm companies' sustainability performance; 2) unachievability of "top marks" due to a lack of transparency on methodology and respective requirements; 3) significant fees for additional rating services such as further insights into rating requirements, i.e. the opportunity to reach "higher marks" often comes with significant costs for rated companies, resulting in an unlevel playing field across rated companies.

In the interest of rated companies an EU regulation of ESG assessment providers should also address potential conflicts of interests as providers often assess companies while also selling consulting services to that company.

Q2. Please provide your views on the level of risk ESG ratings currently pose to orderly markets, financial stability and investor protection in the EU. Do you consider this level will increase in the coming years?

In our view, ESG ratings currently do not pose a threat to regulated markets. In this respect, it should be noted that while the potential financial risks of climate change and other environmental, social and governance (ESG) considerations are becoming increasingly important to investors, ESG ratings are obviously not used as the sole factor in investment decisions. Solvency II includes an obligation to consider all relevant risks, including ESG risks, both in the risk management and investment process.

However, the more binding ESG ratings become in their regulatory application for investors, the more likely risks to financial stability could arise in the future, for example if this leads to a need to sell in the same direction if certain techniques, companies or countries are suddenly deemed insufficient to meet ESG requirements.

Berlin, March 11, 2022