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FAO: The ESG Data & Ratings Working group (“DRWG”)

Submitted by e-mail to: drwgsecretariat@icmagroup.org

CFA UK’s Response to ICMA’s & IRSG’s Joint consultation on the Draft Code of Conduct for ESG Ratings and Data Product Providers

The CFA Society of the UK (‘CFA UK’)¹ welcomes the opportunity to comment on the International Capital Markets Association’s (‘ICMA’) and the International Regulatory Strategy Group’s (‘IRSG’) joint consultation (‘the Consultation’) on the draft Code of Conduct (the ‘Code’) for ESG Ratings and ESG Data providers (together, ‘ESG Service Providers’).

SCOPE OF THE CODE

HM Treasury recently consulted on whether both ESG Ratings Providers and ESG Data providers should be regulated². CFA UK responded to this consultation³ and opined that ESG Ratings Providers should be regulated but that ESG Data Providers should not be⁴. In our response we recognised the strong linkages between both types of firms but took the view that regulation of Data Providers was at this stage impractical and that UK alignment with the recently introduced EU regulation made sense. We acknowledge that views across the UK investment industry on this question are mixed⁵ and that the scope of the future regulation, including that of any size threshold, is yet to be determined. As regards the Code, however, we welcome the work of the DRWG and hope that both ESG Data and Ratings Providers will look to become signatories of it, regardless of size.

We believe that both investment firms and ESG Ratings Providers who use third party ESG data in the determination of their investment or rating decisions need to take adequate steps themselves to verify its quality and accuracy, particularly with regard to data which

¹ CFA UK is a professional body representing over 11,000 investment professionals in the UK. Appendix I contains a summary of the mission, purpose and activities both of CFA UK and that of our umbrella organisation, CFA Institute.

² HM Treasury’s Consultation on the Future Regulatory Regime for ESG Ratings and Data Providers (March 2023): <https://www.gov.uk/government/consultations/future-regulatory-regime-for-environmental-social-and-governance-esg-ratings-providers>

³ CFA UK’s response to HMT’s Consultation regarding the future regulatory regime for Environmental, Social and Governance (ESG) ratings providers (30 June 2023): <https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/response-to-hmt-re-esg-ratings-final.pdf>

⁴ See our response to question 6 of the consultation: <https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/response-to-hmt-re-esg-ratings-final.pdf>

⁵ See other responses from the Investment Association (June 2023): <https://www.theia.org/sites/default/files/2023-07/FINAL-%20IA%20Response%20to%20HMT%20ESG%20Ratings%20Consultation%2020230629.pdf>, the Investor Relations Society (June 2023): <https://irsociety.org.uk/resources/news/item/society-responds-to-the-esg-data-and-ratings-hm-treasury-consultation> and PIMFA (June 2023): <https://www.pimfa.co.uk/wp-content/uploads/2023/07/PIMFA-response-HMT-consultation-on-regulating-ESG-ratings-providers.pdf?v=79cba1185463>

they deem material to an investment or rating decision. This view accords with *Standard V(A) Diligence & Reasonable Basis of CFA Institute's Code of Ethics and Standards of Professional Conduct*. We believe that one of the steps investment firms and ESG ratings providers can take is to require their ESG data providers to have their data processes independently assured or to have standardised reporting (see point 4 below).

ALIGNMENT WITH IOSCO'S FOUR PRINCIPLES

The drafting of the DRWG's consultation is very clear and we welcome in particular the transparency afforded by the mapping exercise to the IOSCO principles in Annex 3. We recognise the advantages of aligning the Code with the IOSCO principles to facilitate its use and recognition globally. However, we believe there are a number of areas where the drafting of the Code should be strengthened; and we hope that this can be achieved without compromising the aim of the Code winning global use and recognition.

We discuss our suggested points to strengthen the Code below. Many of these are informed by the principles and standards laid down in *CFA Institute's Code of Ethics and Standards of Professional Conduct*⁶ and the expectations that CFA Institute has of analysts who are already CFA charterholders or candidates in the CFA program.

In addition, we provide our responses to the four questions raised in Annex 1 of the joint consultation in Appendix II of this letter.

COMMENTS ON THE DRAFT CODE:

- 1. Establishing (and funding) a Secretariat for the ongoing administration of the Code:** we applaud the excellent and detailed work of the DRWG in producing the draft Code and the Consultation document. However, we note that there appears to be no provision for a body or secretariat to manage the future administration and governance of the Code. As acknowledged in paragraph 2.4 of the consultation, this is a dynamic industry, and we anticipate that the Code itself will need to be subject to periodic review and potential revision within its initial years of operation in order to remain fully relevant and close any gaps identified. For the Code to become globally recognised and firmly established we believe the governance and administration of the Code needs to be provided for from the outset - if not still commissioned under the FCA then by some other sufficiently independent body.
- 2. Standards/Guidance:** adding supplemental guidance or standards to the Code over time would strengthen the Code by providing proper definition around the expectations of the Code. This could be ongoing work for the Secretariat referred to above in point 1. We encourage again reference to *CFA Institute's Code of Ethics and Standards of Professional Conduct*⁶ where the Code sets the principles and the aspirations whilst the Standards, supported by a Handbook of guidance, provide greater granularity and scenarios to illustrate expected practices and behaviours.

⁶CFA Institute's Code of Ethics and Standards of Professional Conduct – "the benchmark for professional conduct for investment professionals around the globe." CFA Institute members, CFA Program candidates, or CIPM Program candidates are required to follow the CFA Institute Code of Ethics and Standards of Professional Conduct: <https://www.cfainstitute.org/en/ethics-standards/ethics/code-of-ethics-standards-of-conduct-guidance>

3. **Annual Application/Attestation:** rather than requiring that an ESG Service Provider annually attest that they are in compliance with the provisions of the Code, we believe it would be helpful for each signatory to briefly explain and publish why they believe they are in compliance with each of the six Principles of the Code. This would at least provide end users with a baseline of evidence that the ESG Service Provider had given some proper and thorough thought to their business and processes being in compliance and not simply 'signed up'.
4. **Application/Attestation and/or Independent Verification/Assurance:** we believe that it would be helpful to end users if ESG Service Providers were required to also state whether their 'Annual Statement of Application' has been independently verified or assured, or not, and the name of the verification or assurance firm. The same principle continues to apply to *CFA Institute's Global Investment Performance Standards (GIPS)*⁷ where investment firms can hire a verification company to attest that their performance presentations were made in compliance with the GIPS standards. In the same way, ESG Service Providers could hire a verification company, potentially one from a list of such firms approved by the FCA, to attest that the ESG Service Provider is in compliance with the Code.
5. **ESG Data Assurance:** We strongly believe that Data Providers, specifically, need to work towards facilitating independent assurance of their processes and handling of data inputs. Investors are increasingly required to make their own ESG reporting so they require assurance on the inputs on which they rely for making those disclosures. The data provider industry will therefore need either to provide ready access to external assurers or provide standardised reporting that provides assurance, such as an AAF 01/20. We believe this should be added as a further Action under Principle 4, Transparency, specifically for ESG Data Providers.
6. **Negative Scope:** whilst we agree with the conclusions in paragraph 3.10 (b) and (c) of the consultation document that, respectively, internal ratings units and ESG consultants should be considered not in scope, we would argue that such organisations consider the Code as a source of ideas and inspiration for their processes, procedures and overall governance of their own operations.
7. **Clause 1.4:** we believe that 'sufficiently independent' should be inserted before 'oversight'. Oversight can be rendered ineffective if the people performing it are too fully involved in the 'determination or publication' of the ESG ratings or data. This accords with *Standard I(B): Independence & Objectivity of CFA Institute's Code of Ethics and Standards of Professional Conduct*.
8. **Clause 2.9(B):** we agree that ESG ratings methodologies should be regularly reviewed. When a methodology change is made, we believe that a 'sufficient communication' should include a worked example to facilitate users' understanding of the change. We also agree that not only 'potential impacts of these changes' should be communicated but we also would expect that all directly attributable changes to actual ESG ratings should be clearly itemised in the same communication. This would mirror the actions expected of CFA charterholders under *Standard III(D) Performance Presentation CFA Institute's Code of Ethics and Standards of Professional Conduct* which demands that the effects of methodology changes should be explained by showing both the old (rating) pre-change and the new (rating) post-change.

⁷ CFA Institute's Global Investment Performance Standards have been recognised by regulators worldwide: <https://www.gipsstandards.org/>

9. **Clause 3.1:** we suggest adding the word ‘owners’ before ‘officers and employees’ as undue influence on ESG Services could just as easily be asserted by an owner, potentially a political lobby group or industry trade body, as much as an employee or officer.
10. **Clause 3.11(D):** we agree fully with the principle that all relevant compensation arrangements should be disclosed. This accords with *Standard VI(A) Disclosure of Conflicts and Standard IV(C): Referral Fees of CFA Institute’s Code of Ethics and Standards of Professional Conduct*. We would note further that such arrangements can take the form also of one-off transactional payments that are not direct compensation and may not necessarily be in the context of a wider ‘business or financial relationship’. We would therefore suggest inserting the word ‘transactional’ after ‘business’ to cover, for example, the payment of an ESG ratings analyst’s travel expenses - if these are lavish and excessive this could become a source of bias in the analyst’s ESG rating. This addition would be in accordance with *Standard I(B): Independence & Objectivity of CFA Institute’s Code of Ethics and Standards of Professional Conduct*.
11. **Clause 4.5(B) & Clause 4.7:** for information to be transparent, we believe it should also be concise. Therefore, we believe that under clause 4.5(B) the ESG Ratings and Data Providers should ‘clearly and concisely’ describe their ESG ratings and data products. Likewise, under clause 4.7, “ESG ratings providers should.....publish clear and concise information that is relevant to understanding their methodologies...”. Overly verbose descriptions of methodologies can sometimes be impenetrable.
12. **Clause 4.13 (F):** we agree that the analyst should declare both the qualitative and quantitative information sources used in their assessment. However, we believe they should also indicate the degree to which their assessment is qualitative or quantitative. This would accord with *Standard V(B) Communications with clients and prospective clients of CFA Institute’s Code of Ethics and Standards of Professional Conduct* which requires analysts to distinguish between fact and opinion in their recommendations to clients. We also think it would be helpful, if appropriate, for the ESG Service Provider to indicate or describe whether the qualitative judgement was that of a single analyst or of one, or more, committees. In this way the end user can better appreciate the degree of risk of a given opinion being inaccurate, subject to ‘groupthink’ or an outlier.
13. **Clause 4.13 (F):** we agree that ESG analysts or data providers should declare their information sources, but we believe further that they should, if necessary, also be prepared to provide a view of the reliability of the data and/or discuss any possible sources of error in it. This accords with *Standard V(B): Communications with Clients and Prospective Clients of CFA Institute’s Code of Ethics and Standards of Professional Conduct* under which CFA charterholders are required to distinguish between facts and opinions in their investment recommendations to clients. If an analyst in concluding that a fact is, in their opinion, ‘likely’ or ‘probably’ reliable rather than a certain sourceable fact, then they should declare the judgement they are making.
14. **Clause 6.10 (C):** ESG analysts should bring attention to any factual errors and omissions, but importantly, we would expect this should be done ‘in a timely manner’. In today’s digitally driven investment world where text can be ‘scraped’ and recycled into new reports by computers in minutes, old inaccurate data can easily become a source of poor decisions and it is important that it is corrected quickly to minimise harm. At present, we believe that it would not be unusual for incorrect ESG data to survive in the public domain for up to 18 months before it has been effectively cleansed.

In line with our Society's purpose, we aim to highlight relevant issues to help the investment community to serve its stakeholders well and to build a more sustainable future. We will be sharing this response with our members and subsequently posting it publicly on our website. In our communique to members, we will be including the table in Appendix III which provides a summary of our specific recommendations above and our view of the potential consequences if these recommendations are not adopted by the DRWG.

Should any of the contents of this letter require further clarification we would be delighted to engage further and seek to provide it.

Yours sincerely,



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and for the oversight of the [Professionalism Steering Committee](#)

APPENDIX I: About CFA UK and CFA Institute

CFA UK serves over eleven thousand leading members of the UK investment profession. Many of our members work either managing investment portfolios, analysing and advising on investments, or in some form of investment operations and oversight role.

The mission of CFA UK is to build a better investment profession and to do this through the promotion of the highest standards of ethics, education and professional excellence in order to serve society's best interests. Many of our members work for Data Service Providers or are end users of their products and services.

Founded in 1955, CFA UK is one of the largest member societies of CFA Institute and provides continuing education, advocacy, information, networking and career support on behalf of its members.

CFA UK has pioneered the development of ESG-related examinations for investment professional in recent years, specifically the Certificate of ESG Investing (now run by CFA Institute), the Certificate of Climate Investing and the Certificate of Impact Investing (currently under development).

Most CFA UK members have earned the Chartered Financial Analyst® (CFA®) designation or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

For more information, visit www.cfauk.org or follow us on Twitter @cfauk and on LinkedIn.com/company/cfa-uk/.

CFA Institute is the global association for investment professionals that sets the standard for professional excellence and credentials.

The organisation is a champion of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors' interests come first, markets function at their best, and economies grow.

It awards the Chartered Financial Analyst® (CFA) and Certificate in Investment Performance Measurement® (CIPM) designations worldwide, publishes research, conducts professional development programs, and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry.

There are nearly 200,000 CFA® charterholders worldwide in more than 160 markets. CFA Institute has ten offices worldwide, and there are 160 local societies.

For more information, visit www.cfainstitute.org or follow us on [LinkedIn](#) and Twitter at [@CFAINstitute](#).

APPENDIX II: CFA UK RESPONSES TO QUESTIONS

Section 1: Interoperability

Q1: How would the proposed scope of this Code of Conduct interact with initiatives related to ESG ratings and data products in other jurisdictions, such as existing or proposals for regulation or Codes of Conduct? Are there any particular issues that you think might limit its international operability with other similar initiatives?

The close mapping of the Code to the IOSCO principles is helpful for the international profiling of the Code. However, we are mindful that globally there may now be 1,000 or so ESG Service Provider firms and that for many the UK will not be necessarily their main market. Other codes will be under development and it might be overly onerous for ESG Service providers to ensure compliance with several codes on a continuing basis.

We have yet to see whether ESG Data Providers will become regulated in the UK and whether proportionality will apply to the size of the ESG Ratings firms that fall into the regulatory perimeter. We believe it is likely that the UK's new ESG Rating and Data Regulation will not apply to all ESG Services provider firms and that therefore it can serve as a minimum baseline of assurance for those (smaller) firms not under full regulation. It can also serve as a useful guidance for those firms that become fully regulated.

Q2: Taking into account the Code of Conduct's degree of alignment with IOSCO recommendations and the consideration it gives to other international approaches (such as Japan's or Singapore's), do you think that the Code of Conduct could and/or should serve as a global baseline for ESG Ratings and Data Product Providers?

As it is based on the IOSCO recommendations and is comprehensive in nature, we believe the Code has a good chance of becoming established as a global baseline after a few years.

In our covering letter, we recommend a number of what we perceive to be important changes to the wording of the Code. Whilst these are departures from the exact wording of the IOSCO recommendations, they represent enhancements and not contradictions with the principles of what IOSCO was seeking.

We hope that by strengthening the Code in this way, application by ESG Service Providers to this Code will become a competitive advantage amongst their clients and potential clients. If the Code became more stringent than the IOSCO baseline in some important areas, discerning end users should value the products of those ESG Service Providers who are signatories of the Code over and above those who are signatories of other less stringent codes. We firmly believe that end users will sponsor a 'race to the top' in code standards as opposed to a 'race to the bottom'.

In achieving this global baseline status it is important that the Code is established with an effective and funded secretariat on an ongoing basis in the same way as for example the UK Money Market Code or the Global FX Code.

Section 2: Differentiation of ESG Ratings and ESG Data Products

Q3: Noting the distinction drawn between ESG ratings and data products, is the Code of Conduct sufficiently clear on how its principles apply to ratings products and/or data products, respectively?

- **Principle 1 Governance** – yes, this applies equally to ESG ratings and data products.
- **Principle 2 Securing Quality (Systems & Controls)** – yes, this applies equally to ESG ratings and data products, though the additional clauses from 2.7-2.12 would seem to apply more to ESG Ratings Providers than ESG Data Providers.
- **Principle 3 Conflicts of Interest** – yes, this applies equally to ESG ratings and data products. Though we note that there is no reference to consideration of divestment of certain other activities such as a requirement under the EU’s ESG Ratings regulation
- **Principle 4 Transparency** - this largely applies equally to ESG ratings and data products, though we note the proposed additional clauses from 4.7-4.16 apply only to ESG Ratings Providers. As explained in point 4 of our cover letter, we would propose the addition of an Action specifically on ESG Data providers to either to provide ready access to external assurers or provide standardised reporting that provides assurance, such as an AAF 01/20.
- **Principle 5 Confidentiality (Systems & Controls)** - yes, this applies equally to ESG ratings and data products.
- **Principle 6 Engagement (Systems & Controls)** - yes, this applies equally to ESG ratings and data products.

Section 3: Forward looking information

Q4: Some stakeholders have encouraged there to be an explicit statement as to whether a methodology incorporates forward looking information, such as Transition Plans. We would welcome views on the proposal to include an action encouraging such disclosure?

If we understand the purpose of the question correctly, we suspect that such a declaration, if required, would become boilerplate and therefore as such potentially meaningless as all ESG Service Providers would probably include it to avoid liability.

As we perceive it, the relevant risk for Principle 5 is not that of an ESG ratings or data provider publishing forward looking information or, indeed, non-public information, but material non-public information (MNPI):

- It is indeed possible that the decision to change an ESG Rating, even one based only on publicly available ESG information, would currently constitute MNPI, especially when it is from a leading provider and especially when it concerned a company with a new rating sufficiently low that the mandates of capital providers could stipulate a

need to sell relevant investments. In other words, we believe that ESG ratings themselves may on occasions already have the same MNPI status as, for example, credit ratings. We believe this is a grey area where clarity would be welcome. ESG ratings are becoming more important, not less, so the risk is that such ratings will become MNPI over time even if they are not today.

- We would note also the possibility that the materiality status of certain information can change over time i.e. non-material, non-public information could become MNPI several days, weeks or months after an ESG Service Provider may have made it selectively available to its pay-wall clients.

As regards Transition Plans, specifically, we would expect covered entities to have made these public already; we also believe that ESG Service Providers including information from Transition Plans would be preferred by end users over those that did not.

A similar possible additional requirement would be to ask ESG Service Providers to state whether they have factored in double-materiality considerations into the data or ratings they provide. This is less likely to have MNPI issues as the externality of the double-materiality should, by definition, be publicly observable. We believe that ESG Service Providers including double-materiality information from covered entities would be preferred by some end users over those ESG Service Providers that did not.

**APPENDIX III: SUMMARY OF CFA UK RECOMMENDATIONS & POTENTIAL CONSEQUENCES
IF NOT ADOPTED**

	CFA UK RECOMMENDATION	POSSIBLE CONSEQUENCES IF RECOMMENDATION NOT ADOPTED
1	Procedures and funding for the ongoing governance and administration of the Code should be provided for from the outset - if not by the FCA then by some other sufficiently independent body.	A failure to provide this could mean that the Code is not kept updated to reflect developments in the sector and most recent best practice.
2	Add supplemental guidance or standards to the Code over time to strengthen it by providing further definition around the expectations of the Code.	Practices of Code signatories could vary materially with some providers doing the very minimum.
3	Rather than just requiring that an ESG Service Provider annually attest compliance with the Code, signatories should briefly explain and publish why they believe they are in compliance with each of the six Principles of the Code.	ESG service providers could more easily sign up to the Code without properly considering and implementing all its points.
4	ESG Service Providers be required to also state whether their 'Annual Statement of Application' has been independently verified or assured, or not, and the name of the verification or assurance firm.	Reduced market confidence in the ESG service provider's product, particularly an ESG Data provider's product.
5	ESG data providers to provide ready access to external assurers or provide standardised reporting that provides assurance, such as an AAF 01/20.	Reduced market confidence in the ESG Data provider's product.
6	Clause 1.4: 'sufficiently independent' should be inserted before 'oversight'.	ESG ratings and data subject to bias or inaccuracies.
7	Clause 2.9(B): 'sufficient communication' should include a worked example to facilitate users' understanding of the methodology. Not only 'potential impacts of these changes' should be communicated but all directly attributable changes to actual ESG ratings should be clearly itemised.	Opacity in ESG rating changes resulting from changes in ESG rating methodology. A loss of market confidence in the ESG Ratings product.
8	Clause 3.1: we suggest adding the word 'owners' before 'officers and employees'.	ESG ratings and data subject to hidden bias.
9	Clause 3.11(D): insert the word 'transactional' after 'business' to cover, for example, the payment of an ESG ratings analyst's travel expenses.	ESG ratings and data subject to hidden bias.

10	Clause 4.5(B) & Clause 4.7: insert the word “concise” and “and concisely”.	Opaque methodologies leading to a lack of accountability in the determination of ESG ratings and a resulting loss of market confidence in the quality of the ESG ratings firm.
11	Clause 4.13 (F): ESG analysts or data providers should also be prepared to provide a view of the reliability of the data and/or discuss any possible sources of error in it.	Publication of inaccurate ESG ratings and data.
12	Clause 4.13 (F): analysts should (i) indicate <u>the degree to which</u> their assessment is qualitative or quantitative and (ii) indicate or describe whether the qualitative judgement was that of a single analyst or of one, or more, committees.	ESG ratings and data subject to hidden bias.
13	Clause 6.10 (C): ESG analysts should bring attention to any factual errors and omissions ‘in a timely manner’.	Materially inaccurate ESG data surviving in the digital public domain for potentially many months and resulting in wrong decisions made on false information.