FINANCIAL CONDUCT AUTHORITY

ESG integration in UK capital markets: Feedback to CP21/18

Feedback Statement

FS22/4

June 2022

Contents

Moving around this document

Use your browser's bookmarks and tools to navigate.

To **search** on a PC use Ctrl+F or Command+F on MACs.

1 Summary

1.1 In CP21/18, published in June 2021, we included a discussion chapter (Chapter 4) on environmental, social and governance (ESG) integration in UK capital markets. We sought initial views from stakeholders on the following topics:

1. Issues related to green, social, sustainability and sustainability-linked debt instruments (ESG-labelled debt instruments), including:
   a. Prospectus and 'use of proceeds' (UoP) bond frameworks
   b. The role of verifiers and second party opinion (SPO) providers
2. ESG data and rating providers

1.2 These are active areas of industry debate. We asked for feedback on potential harms that may require further policy intervention, as well as input on other actions the FCA could take to enhance primary market effectiveness and to support more broadly our strategic objective to make relevant markets function well.

1.3 This Feedback Statement (FS) brings together respondents' views and sets out potential future actions. In Chapter 2, we include some background on the evolving landscape for ESG-labelled debt instruments, and ESG data and rating providers. Chapter 3 summarises feedback to the discussion chapter in CP21/18 and our response. Finally, in Chapter 4, we set out our policy actions and potential future direction of travel.

1.4 We see a clear rationale for regulatory oversight of certain ESG data and rating providers – and for a globally consistent regulatory approach informed by the recommendations on ESG data and ratings developed by the International Organization of Securities Commission (IOSCO) in 2021.

1.5 We therefore support the Government's consideration of bringing ESG data and rating providers within our regulatory perimeter. As noted by the Economic Secretary to the Treasury and our Chief Executive Officer, 'common baseline standards that support innovation would allow the UK to lead globally'.

1.6 We are taking a measured approach to ESG-labelled debt instruments, with the aim of setting clear guard-rails as the market continues to develop. Published alongside this FS, Primary Market Bulletin 41 (PMB 41) sets out in further detail our approach. In the PMB:

- we encourage issuers of ESG-labelled UoP debt instruments to consider voluntarily applying or adopting relevant industry standards, such as the Principles and Guidelines that the International Capital Market Association (ICMA) has developed for green, social, and sustainability bonds
- we remind issuers, their advisors and other relevant market participants of their existing obligation to ensure any advertisement is not inaccurate or misleading, and is consistent with the information contained in the prospectus
- we also encourage issuers and their advisors to consider verifiers' and assurance providers' expertise and professional standards, and to engage with SPO providers

and verifiers who adhere to appropriate standards of professional conduct, such as ICMA's Guidelines for External Reviewers.

Who will be interested in this feedback statement

1.7 This FS is likely to be of interest to, but not limited to, the following stakeholders:

- regulated firms
- listed companies and their advisors and sponsors
- investors and asset owners
- verifiers and SPO providers
- accountants and auditors
- ESG data and rating providers
- consumer groups and individual consumers
- industry groups, trade bodies and civil society groups
- policymakers and regulatory bodies
- industry experts and commentators
- academics and think tanks

The wider context

Link to our strategy and objectives

1.8 In our ESG Strategy, published in November 2021, we stressed that market participants and consumers must be able to trust green and other ESG-labelled financial instruments and products.

1.9 A key target outcome of our ESG Strategy – also reflected in our 2022/23 Business Plan and our 2022-2025 FCA Strategy – is to promote 'integrity in the market for ESG-labelled securities, supported by the growth of effective service providers – including providers of ESG data, ratings, assurance and verification services'. The publication of this FS and the accompanying PMB will support this outcome by clarifying our views on current practice in ESG-labelled bond markets, and potential next steps in relation to ESG data and rating providers.

1.10 Promoting trust in both ESG-labelled debt instruments and ESG data and ratings directly contributes to our overarching strategic objective to ensure that relevant markets function well, and to advancing our three operational objectives:

- to secure an appropriate degree of protection for consumers
- to protect and enhance the integrity of the UK financial system
- to promote effective competition in the interests of consumers

Latest developments

1.11 Since we published CP21/18, the ESG-labelled debt market has continued to grow. Regulatory scrutiny around ESG data and rating providers has also intensified.

1.12 Chapter 2 provides some evidence on the pace of growth in the global issuance of UoP bonds and sustainability-linked bonds (SLBs). Having surpassed $1 trillion in 2021, expectations for total issuance of sustainable bonds in 2022 have been as high as $1.5 trillion.

1.13 In parallel, the Treasury published in March 2022 the outcome of the UK Prospectus Regime Review. This sets out the policy approach the Government will take to reform the UK prospectus regime, and their intention to legislate when parliamentary time allows.

1.14 In respect of ESG data and rating providers, the Government signalled in its Roadmap to Sustainable Investing last October that it is considering bringing these providers within our regulatory perimeter. We also considered the role of these providers in our own Perimeter Report 2020/21.

1.15 Other jurisdictions in the European Union (EU) and Asia are also contemplating closer oversight of these entities. Noting the global reach of these providers and the importance of globally consistent regulation in this market, we contributed to IOSCO's recommendations to both regulators and ESG data and rating providers, published last November.

Our target outcomes

1.16 As noted in our ESG Strategy and Business Plan 2022/23, the financial sector has an important role to play in supporting the transition to a net zero economy and a more sustainable long-term future. We are pursuing, where appropriate, a market-based transition that supports the Government's aim to achieve a net-zero economy by 2050. This aligns with the Government's expectation, introduced in the Chancellor's remit letter to the FCA in 2021.

1.17 In this FS, we focus on the following outcomes – which are directly relevant to our strategic and operational objectives:

- **ESG-labelled debt instruments.** Market participants must be able to trust the claims made by issuers regarding the sustainability characteristics of green and other ESG-labelled financial instruments and to rely on them to perform as they expect.
- **ESG data and rating providers.** As industry participants more fully integrate ESG into their activities and expand their ESG-focussed product offerings, they are increasingly reliant on third-party ESG data and rating services. These services are increasingly embedded within investment processes (including mandates and benchmark indices), directly influencing capital allocation. To avoid potential for harm to markets and, ultimately, consumers, we consider that ESG data and rating services should be transparent, well-governed, independent, objective, and based on reliable and systematic methodologies and processes. Where ESG data and rating services aim to measure specific ESG attributes, users of those services should be able to clearly interpret their objectives and access sufficient information to be able to assess whether their outputs are fit for purpose. We expect this to lead, in turn, to better information for consumers and investors to make their investment decisions, and to more effective competition.

1.18 We note that enabling these outcomes will continue to require close engagement with the Government, other regulators and industry.

Summary of feedback

1.19 We received 50 responses to the discussion chapter included in CP21/18. We summarise the feedback below in two separate sections:

1. Issues related to ESG-labelled debt instruments
2. ESG data and rating providers

Issues related to ESG-labelled debt instruments

1.20 Overall, respondents did not support additional measures by the Government or the FCA to strengthen the terms related to use of proceeds within contractual agreements, or to enhance the information on use of proceeds required to be disclosed in a prospectus. Views were mixed regarding the development of a 'UK Green Bond Standard', on the lines of that proposed in the EU.

1.21 However, respondents supported some form of recognition or encouragement by the FCA for issuers and their advisors to adhere to existing industry principles for ESG-labelled debt instruments, notably ICMA's Principles and Guidelines for UoP bonds.

1.22 Given the increasing importance of external reviews in the ESG-labelled bond market, respondents supported some form of regulatory oversight of SPO providers and verifiers. The majority agreed with the potential harms set out in our discussion chapter and encouraged steps to manage conflicts of interest, enhance transparency, and promote good governance.

1.23 The key points of feedback are elaborated in Chapter 3. We have published PMB 41 alongside this FS to address some of these issues and to encourage issuers and their advisors to uphold high standards of market practice.

ESG data and rating providers

1.24 Overall, respondents supported our analysis of the challenges and potential harms in this market. Most respondents supported increased regulatory oversight of ESG rating providers, noting that rating services rely on considerable judgement and/or data-driven methodological processes. Some considered that any enhanced regulatory remit should also extend to other ESG data providers.

1.25 Respondents also agreed with our assessment that a regulatory focus on transparency, governance/systems and controls, and management of conflicts of interest would help to achieve better outcomes for markets and consumers. Considering the global reach of ESG data and rating providers, many respondents strongly supported an internationally coordinated approach that had regard to IOSCO's recommendations.

Our response – policy actions and potential future direction

1.26 Considering the feedback received and latest developments in each market, we set out below the key policy actions we are taking and potential future direction. These are also set out in Chapter 4:

Policy actions

- **Advertisements, bond frameworks and prospectuses.** PMB 41 reminds issuers, their advisors and other relevant market participants of their existing obligation to ensure any advertisement issued in relation to an offer to the public or admission to trading on a regulated market is not inaccurate or misleading, and is consistent with the information contained in the prospectus. Where advertisements do not meet our expectations, we will consider the case for market oversight or enforcement actions.
- **Voluntary adoption of existing industry standards.** Also in PMB 41, we encourage issuers and their advisors to consider relevant industry standards – such as the ICMA Principles and Guidelines for green, social, and sustainability bonds – when issuing ESG-labelled debt instruments
- **Oversight of verifiers and SPO providers.** Similarly, we encourage issuers to consider relevant industry standards – such as the ICMA Guidelines for Green, Social, Sustainability and Sustainability-Linked Bonds External Reviews – when selecting their SPO providers and verifiers. We also encourage verifiers and SPO providers themselves to consider voluntarily applying these guidelines. In particular, the ICMA Guidelines encourage such providers to consider – where relevant – using recognised standards and codes, including those developed by the International Audit and Assurance Standards Board (IAASB) and the International Ethics Standards Board for Accountants (IESBA).
- **ESG data and rating providers.** Consistent with the feedback received and the position in IOSCO's recommendations, we see a clear rationale for regulatory oversight of certain ESG data and rating providers. So, we will continue to work with the Treasury, who are considering bringing ESG data and rating providers within our regulatory perimeter.

Potential future direction

- **Bond frameworks and prospectuses, and bond standards.** We note that the Treasury has published the outcome of its Prospectus Regime Review, setting out proposals to reform the UK's regime for public offers of securities and admissions to trading on capital markets. When implemented, these would give the FCA additional responsibility to set out the detail of the new regime through Handbook rules. While this is a multi-year review, it could potentially provide an opportunity to reconsider prospectus disclosure requirements. In addition, we may reassess in the future, with the Treasury, the case to develop an appropriate standard for UoP bonds.
- **Oversight of verifiers and SPO providers.** We may also consider further, with the Treasury, the case for regulatory oversight of these service providers in the future. Any further actions would also require close engagement with the Financial Reporting Council (FRC).
- **Climate-related disclosures for listed issuers of debt and debt-like securities.** Elsewhere in CP21/18, we asked whether it might be desirable to extend climate-related disclosure requirements to issuers of listed debt and debt-like securities. We received generally supportive responses and provided high-level

feedback in our Policy Statement (PS21/23). We will consider the best way to strengthen and promote transparency on sustainability representations by debt issuers, including in the context of the Treasury's Prospectus Regime Review.

- **ESG data and rating providers.** If the Treasury extends our regulatory perimeter, we will take the necessary steps to develop and consult on a proportionate and effective regulatory regime, with a focus on outcomes in areas highlighted in IOSCO's recommendations. These include transparency, good governance, management of conflicts of interest, and systems and controls. Given the potential lead time before any such regime could come into force, we would – in the interim – work with the Treasury to convene, support and encourage industry participants to develop and follow a voluntary Code of Conduct addressing matters similar to those listed above. Such a voluntary Code could potentially continue to apply for ESG data and rating providers that fall outside the scope of any future regulatory regime.

Equality and diversity considerations

1.27 We have considered the equality and diversity issues that may arise from the proposals in this Feedback Statement.

1.28 Overall, we do not consider that the proposals materially impact any of the groups with protected characteristics under the Equality Act 2010.

2 The wider context

2.1 The market for ESG-labelled instruments and products continues to grow and evolve. This chapter summarises some of the latest developments in the ESG-labelled debt market and makes some observations on the wider ESG data ecosystem.

Growth in the ESG-labelled debt market

2.2 Issuance in the wholesale ESG-labelled debt market has risen significantly in the last few years – both in the UK and globally – with rapid growth in both UoP bonds and, more recently, SLBs.

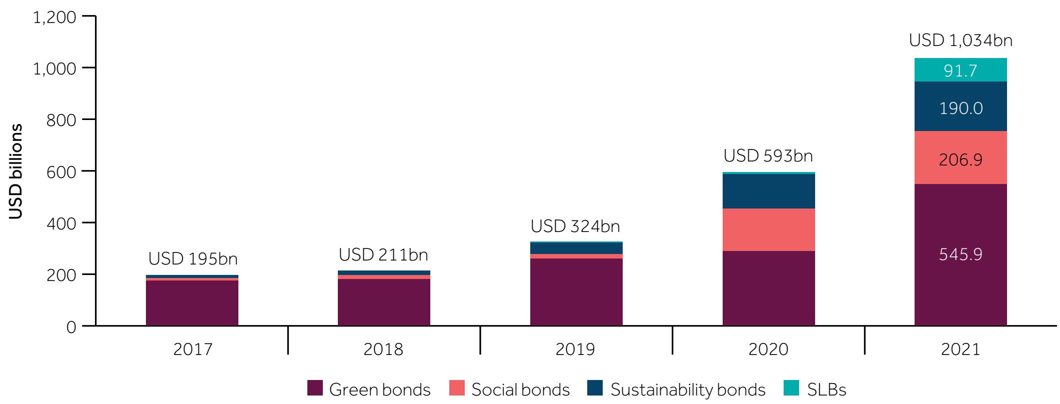
a. UoP bonds are a standard recourse-to-the-issuer debt obligation for which the proceeds are used for a specific project or to finance a sustainable economic activity that is linked to the issuer's investment framework for eligible projects. The market has developed various types of these instruments including green bonds, social bonds, and sustainability bonds.

b. SLBs, by contrast, are a type of bond instrument for which the financial and/or structural characteristics – typically the coupon – can vary depending on whether the issuer achieves predefined sustainability and/or ESG objectives. These objectives generally refer to sustainability performance targets (SPTs), supported by more detailed key performance indicators (KPIs).

2.3 In 2021, according to ICMA, the total issuance volume of UoP bonds and SLBs passed the $1 trillion threshold for the first time – a 75% increase compared with the previous year. While UoP bonds continue to dominate the market, total SLB issuance has grown ten-fold over the last year to reach $91.7 billion, representing approximately 8.8% of total ESG-labelled bonds issuance that year (see Figure 1).

2.4 Expectations for total issuance of ESG-labelled bonds in 2022 have been as high as $1.5 trillion (eg, S&P Global Ratings estimates), though forecasts have been revised down more recently due to the current geopolitical and economic context.

Figure 1: Total issuance volume per ESG-labelled bond type



Sources: ICMA Quarterly Report, Environmental Finance Data (efdata.org)

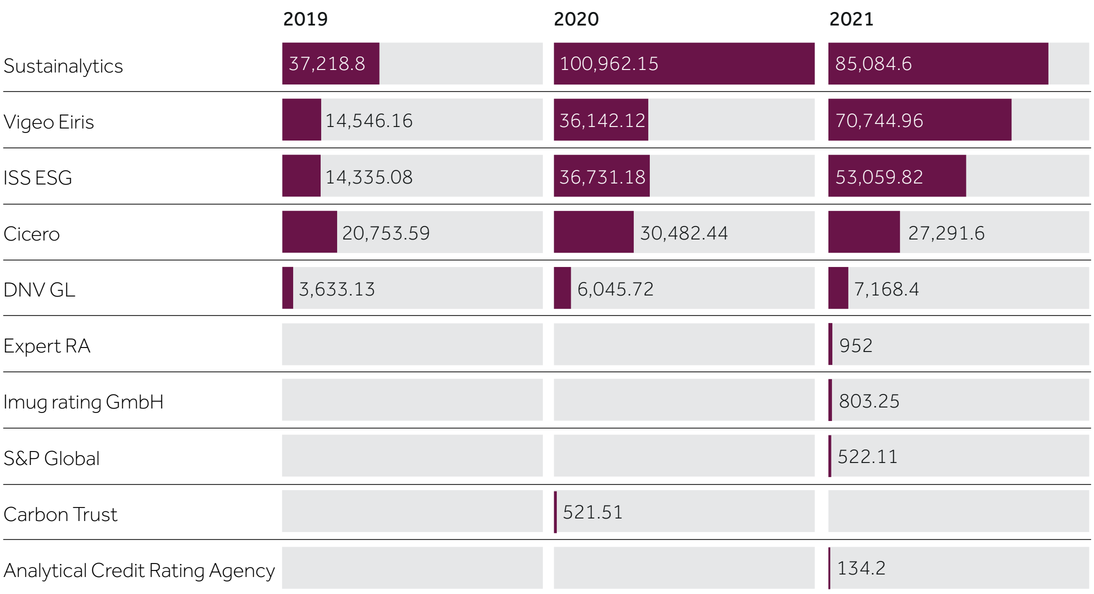
2.5 According to Capital Monitor, 55 UoP bonds were issued in the UK in 2021, up from 38 the previous year and 32 in 2019. The UK was the largest European market in 2021 (for the first time), with $53.5 billion of UoP bond issuance.

2.6 The issuance figures above include the UK Green Gilt, which raised £16 billion last year. The order book was 12 times oversubscribed, further highlighting the strong demand for ESG-labelled debt instruments. This also made the UK, at the time of issuance, one of the top three national issuers of green bonds in the world.

2.7 Market participants increasingly expect that the issuer of a UoP bond or SLB will have its bond framework documentation assessed by a specialist SPO provider. They also expect that post-issuance allocation of proceeds (for UoP bonds) and performance against SPTs (for SLBs) will be verified on an ongoing – usually annual – basis.

2.8 In Europe, Sustainalytics, Vigeo Eiris and ISS ESG are the largest providers of SPO services for UoP bonds, in terms of bond volume (see Figure 2).

Figure 2: Top SPO providers by UoP bond volume in Europe (in $m)



Source: Capital Monitor, GlobalData

International developments

2.9 Most global ESG-labelled bonds, including the UK Green Gilt, are issued in line with at least some of the Principles and Guidelines set out by ICMA. Other standards exist that extend beyond ICMA's Principles and Guidelines.

2.10 For instance, the Climate Bonds Standard developed by the Climate Bonds Initiative (CBI) establishes a taxonomy for the use of proceeds and can be used as a basis for certification.

2.11 And some jurisdictions, such as China and the EU, have developed or are contemplating their own standards. For instance, the EU is currently in the process of establishing a Green Bond Standard, which is expected, among other things, to require external reviewers to be registered with and supervised by the European Securities and Markets Authority (ESMA).

The ESG data ecosystem

2.12 ESG ratings and data cover a broad spectrum of products and services.

2.13 In this FS, the term 'ESG data' represents the wide range of sustainability-related information about a company, financial instrument, product or entity – which can be 'raw' or processed (eg, aggregated, cleaned, estimated, or combined with a degree of judgment).

2.14 We use ESG rating products to refer to services that provide assessments of the ESG profile and/or ESG exposure of a company, fund, or other entity or financial instrument. This category includes rating-like products, such as scores, rankings, evaluations and assessments.

2.15 The unregulated market for ESG data and rating provision is growing rapidly. The landscape continues to evolve as market participants become more reliant on ESG information to support their trading, investment and capital allocation decisions, and to meet their reporting requirements.

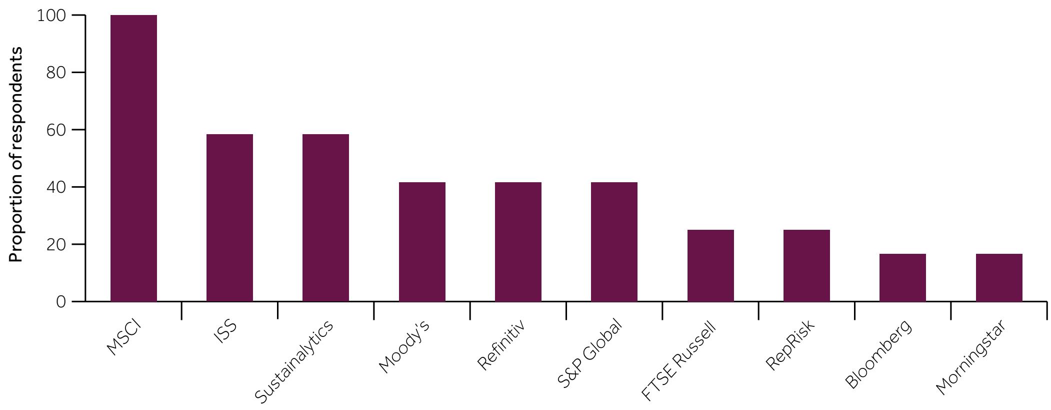
2.16 As merger and acquisition activities continue, and with the frequent entrance of new players, the market appears to be dynamic. In 2020, KPMG estimated there are over 150 major ESG data providers worldwide. More recently, the International Regulatory Strategy Group (IRSG) reported there are around 30 significant ESG rating and data providers globally. And according to Opimas, the top three providers accounted for around 60% of the market in 2021.

2.17 This view of a relatively concentrated ESG data landscape is also reflected in an additional informal survey recently conducted by the ESG Committee of IRSG. The survey provides a high-level overview of how a small sample of large banks and asset managers with a UK presence are using ESG ratings and rating-like products (see Figure 3). The key message is that, while a total of 32 different providers are used across respondents, the services of the top three providers are used by more than half of the respondents, and all those surveyed use the services of the largest provider.

2.18 The survey also finds that over 70% of respondents use rating products on corporate issuers, and 60% of them on sovereign issuers. Some respondents mentioned using ratings on other financial instruments or on carbon offsets.

2.19 Over 90% of respondents mentioned using at least some of these rating products to support their investment analysis and decision-making. Three quarters of those surveyed also used at least some of them as an input to the construction of a benchmark index referenced in their investment products and/or client mandates. Around two-thirds noted some were included as a parameter in one or more investment mandates of their clients.

Figure 3: The 10 most frequently used ESG rating or rating-like product providers



Source: ESG Committee of IRSG

Note: Sample of 12 respondents including 7 banks, 3 asset managers, 1 asset owner and 1 trade association. Five of the respondents were headquartered in the US, 4 in the UK, 2 in the EU and 1 in Asia. Most banks and asset managers reported assets under management of over £800bn.

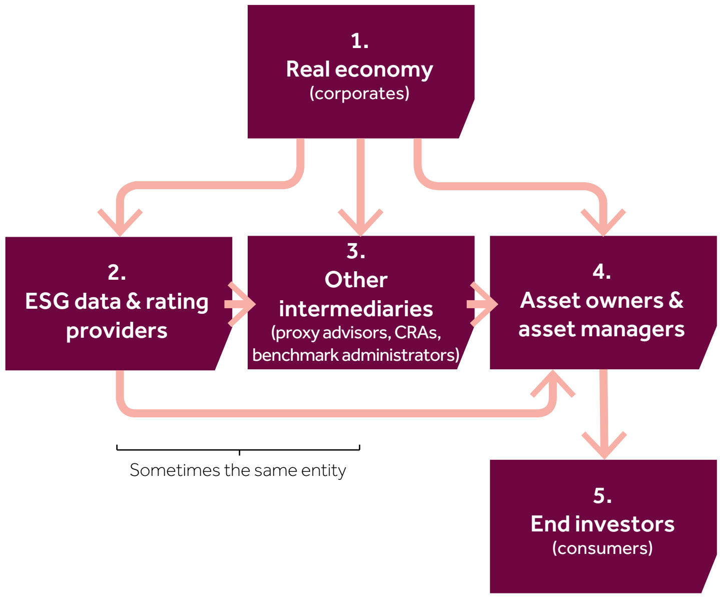
The ESG data ecosystem

2.20 The ESG data ecosystem is complex, with information flowing through an often-lengthy value chain. Figure 4 shows some of the interactions between key actors. It focuses on the use of corporate ESG data to support investment processes.

- At the top of the chain are the primary sources of corporate ESG data: companies in the real economy (point 1 in Figure 4). These data may be found in annual financial reports or dedicated sustainability reports, or collected directly by intermediaries through their interaction with companies or other research activities. With sustainability-related reporting still maturing, these data are currently incomplete and typically subject to only limited audit and assurance. The quality, availability and comparability of sustainability-related corporate disclosures is, however, expected to improve as the IFRS Foundation's International Sustainability Standards Board (ISSB) continues its work to develop a global baseline of reporting standards. We are supporting this work through our involvement at IOSCO.
- At the next level in the chain are the users of the corporate ESG data. These include:
  - data service providers, such as ESG data and rating providers (point 2)
  - other intermediaries, such as benchmark administrators, credit rating agencies (CRAs) and proxy advisors (point 3)
  - asset managers and asset owners (point 4)

  Data may flow between actors at this point in the value chain. For instance, benchmark administrators (at point 3) may rely on data or rating products (offered by providers at point 2) to develop benchmark indices that are used, in turn, by asset owners and asset managers (at point 4). Further, some data, rating and other intermediary services (at points 2 and 3) may be provided by the same entity. As reliance on ESG data grows across the financial sector, these entities are becoming increasingly concentrated points of dependence in financial markets.
- The final level in the chain is the end consumer of financial products (point 5) that rely – to varying degrees – on investment processes that involve research and analysis using ESG data.

Figure 4: Key information flows and interactions in the ESG data ecosystem



2.21 Recognising the complex interactions across the ESG data ecosystem, our ESG Strategy is taking a holistic, cross-cutting approach to assessing potential harms and building trust and confidence. We provide an overview of our approach in Chapter 4.

Risks of harm

2.22 It is commonly observed that there is a very low correlation between different providers' ESG ratings on any given entity.

2.23 We consider that this reflects the inherent multidimensionality of ESG, the multiplicity of ESG rating and rating-like products (often with different aims and objectives), and the continued innovation in methodology as the sector grows and evolves.

2.24 We do not consider the different judgements reached by ESG rating and rating-like product providers inherently to be a source of harm, as long as the providers are:

- transparent about their methodology (eg, key drivers of ratings assessment), and information and data inputs (eg, data sources, approach to data gaps)
- determine their outputs by applying systematic processes and sound systems and controls
- identify and manage conflicts of interest
- operate with robust governance

2.25 These conditions are equally applicable to many value-added ESG data products, especially where the provider exercises judgement. If these conditions are met, users may be more confident that the ESG data and rating products they rely upon are independent and free from bias. Users may also be better equipped to assess different products and to form a view on their fitness for purpose.

2.26 However, some of these conditions may not be fully met in practice, thereby directly posing risks to our operational objectives.

2.27 These risks are also further exacerbated as firms often embed ESG data and rating products into their investment processes. This includes, for example, using ESG ratings as a determinant input to benchmarks and indices, or including them as the basis for investment mandates and strategies. As a result, certain ESG data and rating products may be expected to influence capital allocation decisions, potentially creating systemic effects.

2.28 As a recent example, the holdings of some ESG-labelled indices which embed specific ESG ratings within their methodologies have come under scrutiny following the sanctions imposed on Russia.

2.29 Reflecting some of these concerns, the Government signalled in its Roadmap to Sustainable Investing published last October that it is considering bringing ESG data and rating providers within our regulatory perimeter. Any further steps would be subject to consultation by the Treasury and the FCA.

International regulatory developments

2.30 Regulatory scrutiny of ESG data and rating providers has increased globally. In November 2021, IOSCO published its final recommendations, addressing both regulators, and ESG data and rating providers. We engaged closely with this work, providing extensive input.

2.31 Earlier this year, ESMA also issued a call for evidence on ESG data and ratings and, more recently, the EU Commission published a targeted consultation on these issues. Elsewhere, Japan's Financial Services Agency will issue a draft Code of Conduct for ESG data and rating providers in July, while the Securities and Exchange Board of India published a consultation paper seeking views on a regulatory framework.

2.32 Considering the global reach of these providers, we strongly support an internationally coordinated approach that has regard to IOSCO's recommendations. We see value in coordinating as far as possible with other jurisdictions, on the design of any regulatory approach or voluntary Code of Conduct.

3 Summary of feedback and our responses

3.1 The discussion chapter in CP21/18 (Chapter 4) sought initial views on two main topics related to ESG integration in UK capital markets:

1. Issues related to ESG-labelled debt instruments, including
   a. Prospectus and UoP bond frameworks
   b. The role of verifiers and SPO providers
2. ESG data and rating providers

3.2 The full list of questions included in CP21/18 are set out in Annex 1.

3.3 50 respondents engaged with the content of the discussion chapter. Responses were received from a range of stakeholders, including trade associations, ESG data and rating providers, and asset managers. A list of the non-confidential respondents is available in Annex 2.

Prospectuses and UoP bond frameworks

3.4 Bond issuers set contractual terms accompanied, where applicable, by disclosures in a prospectus prepared in accordance with the UK prospectus regime. A prospectus must be published when an offer of securities is made to the public, or when applying for admission to trading on a regulated market, unless an exemption applies.

3.5 In addition to the prospectus, issuers of ESG-labelled debt instruments also typically publish a bond framework document. Usually aligned with voluntary industry principles, a bond framework document summarises information on the use of proceeds and other key matters. Disclosures in the bond framework are not formally part of the prospectus and are not contractually binding. However, where bond frameworks form part of a communication that relates to an offer or admission of securities, they are likely to be advertisements for the purposes of the prospectus regime. The information in Primary Market Technical Note 604.2 can assist issuers and practitioners in interpreting this regime.

3.6 One potential concern is that the contractual terms of UoP bonds do not reflect the use of proceeds advertised in the bond framework. This potential divergence may lead to investment decisions being based on incomplete or misleading information. We sought views as to whether this could undermine the integrity of this segment of the market. We also explored the case for specific regulatory requirements in respect of bond frameworks, and whether requirements should be considered regarding how the planned use of proceeds is reflected in contractual terms or disclosed in the prospectus.

3.7 Finally, we asked whether we should support the UoP bond market by recognising existing standards, such as the ICMA Principles, perhaps through our industry code recognition process.

UoP bond frameworks and prospectus disclosures

3.8 We asked:

> **Q12:** ***If future changes were considered in relation to the UK prospectus regime, we would welcome views on also taking the opportunity to introduce specific requirements in relation to UoP bond frameworks and their sustainability characteristics?***

3.9 A third of the 24 respondents commented on the need for alignment between the information presented in the prospectus and the bond framework documentation. One respondent explicitly noted claims in bond frameworks tend to be stronger than those in prospectuses. There was broad support, notably from investors, for prospectuses to include minimum disclosures on the types of projects/ activities for which an issuer will use the proceeds of an offering.

3.10 However, respondents spanning the different stakeholder types also highlighted potential issues and challenges that could arise in the event of regulatory intervention. For instance:

- the majority of respondents were concerned that UK-specific rules could cause regulatory fragmentation and were keen that any new requirements considered alignment with existing international standards
- some respondents were concerned that prescriptive rules might hinder the competitiveness of the UK ESG bond market by disincentivising issuers from issuing UoP bonds, or have the unintended consequence of encouraging 'standard-shopping' across international markets
- stricter regulation around UoP bonds may drive issuances towards SLBs, where no restrictions on use of proceeds are required. This could lead to suboptimal outcomes.

Recognition of industry standards

3.11 We asked:

> **Q13:** ***Should the FCA explore supporting the UoP bond market by recognising existing standards (eg, ICMA Principles), potentially through our recognition of industry codes criteria and process?***

3.12 There was widespread support across the 13 respondents to this question for FCA's recognition of globally adopted standards in this area, particularly the ICMA Principles and Guidelines.

3.13 However, there were concerns from some investors and their interest groups regarding the voluntary nature of existing industry standards. These respondents favoured a regulatory direction of travel towards mandatory standards for this market.

UoP bonds and contractual agreements

3.14 We asked:

> **Q14:** ***We would also welcome views on more ambitious measures the FCA could consider, for example to require that the central elements of UoP bonds be reflected in contractual agreements and set out in the prospectus.***

3.15 Most of the 19 respondents to this question (including investors, their interest groups and other financial institutions) were unsupportive of regulatory requirements to strengthen the terms in contractual agreements of UoP bonds and fully align them with extra-prospectus materials, such as the bond framework document. The majority considered that market participants should be left to agree contractual terms between them.

3.16 Many respondents noted that issuers did not always have certainty on the final project evaluation, or allocation of proceeds when agreeing contractual terms and preparing disclosures in the prospectus. Accordingly, there were concerns that requiring issuers to define these elements too precisely in contractual terms and the prospectus could introduce liability risks to issuers. A particular concern was that failure to use proceeds precisely as specified could trigger an event of default.

Our response

UoP bond frameworks and prospectus disclosures

UK prospectus content rules require specific disclosures, including on the use of proceeds and risk factors. However, the UK does not have a compulsory bond standard for ESG-labelled UoP bonds. It is therefore common for an issuer to make it clear that the use of the proceeds of the issuance is not binding, while binding contractual terms tend to be determined by market practice and market forces.

We recognise the potential benefits of a UK ESG bond standard but acknowledge the concerns raised about potential regulatory fragmentation and the unintended consequence of 'standards shopping' (see our response to Q16).

We also recognise the concern that insisting on including the use of proceeds as a binding provision in contractual agreements could increase liability risks for issuers, particularly where issuers do not have full visibility on their future capital expenditure plans and opportunities.

We do not, therefore, propose any changes to our rules framework at this time. However, we note that any current and future changes to prospectus disclosure remain dependent on the outcome of the Treasury's proposals to revise the UK regime for public offers of securities and admissions to trading on capital markets. When implemented, these would give the FCA additional responsibility to set out the detail of the new regime through Handbook rules. While this is a multi-year review, it could potentially provide an opportunity to reconsider prospectus disclosure requirements at that time – subject to discussion and consultation with the industry.

Advertisements
We note, however, that our analysis of a sample of green bond issues revealed that, while prospectus disclosures clearly state that an issuer is not obligated to use the proceeds in a specific manner, the UoP bond framework document often implies a stronger commitment.

We expect issuers, their advisors and other relevant market participants to meet their current obligations regarding prospectus advertisements so as to prevent investors from making investment decisions based on information that is inconsistent with the prospectus.

Specifically, we remind all relevant persons of their existing obligations regarding advertisements under PRR 3.3.1. In particular, Article 22(3) of the UK Prospectus Regulation provides that the information in an advertisement (which must be clearly recognisable as such) must not be inaccurate or misleading, and should be consistent with the information contained in the prospectus. If the bond framework document is an advertisement – ie, any communication relating to a specific offer to the public of securities or to an admission to trading on a regulated market, and that aims to specifically promote the potential subscription or acquisition of securities – it must comply with our rules.

We are issuing – alongside this FS – PMB 41, which reminds issuers' of their obligations in this area under existing rules. Where advertisements fall short of our requirements, we will consider taking additional actions through our Market Oversight and Enforcement powers.

Industry standards
Finally, and as set out in PMB 41, we encourage issuers of UoP bonds and their advisors to coalesce around emerging good practice as reflected in existing industry standards – such as the ICMA Principles and Guidelines for green, social and sustainability bonds. The ICMA Principles and Guidelines are established as the current market standard, being referenced in more than 98% of ESG-labelled bond issuances globally. However, we acknowledge that other standards exist, and market standards may develop over time.

As noted in Chapter 2, CBI's Climate Bonds Standard builds on ICMA's Principles and Guidelines to include a taxonomy and to support certification. Ultimately, firms should use their judgment to ensure they are following industry best practice at all times.

Notably, in the context of claims regarding the use of proceeds, ICMA's Principles and Guidelines stress that '[t]he cornerstone of a … [b]ond is the utilisation of the proceeds of the bond for eligible… [p]rojects, which should be appropriately described in the legal documentation of the security'.

The adoption of these principles can further support good standards in the issuance of ESG-labelled UoP debt instruments and, in turn, the integrity of the market. We also expect the voluntary adoption of these principles and guidelines to ensure uses of proceeds are appropriately described in the relevant legal document of the security.

The role of verifiers and SPO providers

3.17 In the context of ESG-labelled debt instruments, we also sought views on SPO provision and third-party verification of both use of proceeds and sustainability-linked bond issues.

3.18 It is increasingly expected that UoP bonds framework documents are subject to a SPO by a specialist provider, and that the post-issuance allocation of proceeds is verified. We sought views on potential sources of harm in the SPO provider/verifier market, including potential conflicts of interest, which could impact trust in the opinions they provide. We also invited views on the potential development of a UK Green Bond Standard, similar to that contemplated in the EU, which among other things specifies that green bond issues should be subject to an SPO.

FCA oversight of SPO providers and verifiers

3.19 We asked:

> **Q15:** ***We would welcome views on the potential harm set out above and what, if any, actions the FCA or the Treasury should consider.***

3.20 Respondents were generally supportive of some form of FCA oversight of SPO providers and verifiers. The majority of the 24 respondents agreed with the key sources of harm identified in CP21/18, these being: conflicts of interest, insufficient transparency of SPOs' assessment methodologies, and potential shortcomings in governance and systems and controls. Some stakeholders suggested addressing these through either best practice guidance or principles of conduct.

- The majority of respondents agreed that potential conflicts of interest presented the most significant risk of harm in the provision of SPOs and external reviews. A few respondents suggested that this could be addressed by putting in place a code of conduct that would require providers to have robust policies for identifying, managing, and disclosing conflicts of interest.
- Other suggested interventions included: applying regulatory measures to SPOs similar to those that have been put in place for CRAs; or implementing a robust independence framework similar to the IESBA code of ethics.
- Many respondents acknowledged that greater transparency was needed in the market and were supportive of requirements for greater transparency around providers'/verifiers' assessment methodologies. This could include disclosure of the analytical approaches used by providers, their data sources, and their processes for identifying any data gaps.
- Finally, respondents were supportive of the FCA's addressing harms that may arise from shortcomings in governance and systems and controls. Suggested actions included encouraging providers to build technical capacity by employing appropriate staff with the necessary experience and qualifications, as well as requiring providers to have an effective internal control system with robust operational safeguards and quality assurance mechanisms.

UK Green Bond Standard

3.21 We asked:

> **Q16:** ***Should the FCA, alongside the Treasury, consider the development and creation of a UK bond standard, starting with green bonds?***

3.22 Approximately half of the 24 respondents supported the development of a UK Green Bond Standard (GBS). Over half of those in support of a UK GBS favoured a direct link to the forthcoming UK Green Taxonomy. Some investors noted that this could be used as a mechanism to build on existing frameworks such as the ICMA Principles, or the EU GBS. However, many also stressed that this should be a voluntary standard that is closely aligned with existing frameworks to promote international consistency.

3.23 The remaining half of respondents, however, did not support the introduction of a UK GBS, primarily due to concerns that it would either be duplicative of existing standards, or if divergent from these, could cause greater complexity and fragmentation in the market.

Our response

SPO providers and verifiers
We acknowledge the clear feedback received regarding the role of SPOs and the case for regulatory oversight. We note that, at present, both SPO providers and verifiers sit outside our regulatory perimeter. Therefore, were regulatory oversight to be contemplated, this would in the first instance need to be considered by the Treasury. The FRC would also be likely to take a close interest, given their responsibilities in respect of audit and assurance, and we will continue to work closely with them.

In the meantime, we encourage issuers to consider relevant industry standards, such as the ICMA Guidelines for Green, Social, Sustainability and Sustainability-Linked Bonds External Reviews when selecting their SPO providers and verifiers. We also encourage verifiers and SPO providers themselves to consider voluntarily applying these standards. Application of these standards can promote quality, independence and sound ethical standards, directly helping to address the potential harms perceived in this market – particularly around conflicts of interest.

Specifically, the ICMA Guidelines encourage such providers to look to adhere – where relevant – to recognised standards and codes of conduct, including those developed by IAASB and IESBA. In the UK, the relevant standard is '*ISAE (UK) 3000, Assurance Engagements Other than Audits or Reviews of Historical Financial Information*'. This standard requires – where relevant – the application of the FRC's Ethical Standard and other pronouncements established by the assurance practitioner's professional body. We set out further detail on our policy view in PMB 41.

UK Green Bond Standard
Finally, we note the mixed feedback received regarding the development and creation of a UK bond standard. We will therefore continue to engage with market participants and relevant stakeholders, and follow global developments in this space. We may also potentially reconsider, subject to the Government's policy, the case to develop a UK standard for UoP bonds in the wider context of the revision of the Prospectus Regulation. We also acknowledge the role the future UK Green Taxonomy could potentially play in this, since a taxonomy may enable a more targeted disclosure standard for UoP bonds to be developed in due course

ESG data and rating providers

Challenges and potential harms

3.24 ESG data and ratings cover a broad spectrum of products and services. As noted in Chapter 2, financial markets and financial services firms increasingly rely on ESG data and rating products to support ESG-related financial decisions, activities, capital allocation and investment processes. The primary focus of our work has been on ESG ratings and rating-like products (eg scores, rankings, evaluations and assessments), which involve considerable judgement and/or data-driven methodological processes.

3.25 In CP21/18, we identified several specific areas of potential harm from the provision of ESG ratings and rating-like products in particular, especially where these products are embedded into financial services firms' investment processes. We noted harm could potentially arise from:

- **Lack of transparency.** Users of ESG ratings and rating-like products need good transparency of ratings methodologies and processes so that they are able fully to understand, interpret and compare what such ratings measure and how they are determined. If these information needs are not met, users may misunderstand or misinterpret how providers address certain ESG factors in their ratings.
- **Poor governance/systems and controls, and management of conflicts of interest.** Good governance and conflict management, along with sound systems and controls are critical to ensuring that documented ratings methodologies and processes are followed systematically, and that ratings outputs are independent and free from bias. Any shortcomings in governance, controls or conflicts management could impact the quality, reliability and independence of ratings, and, ultimately, undermine trust in the market.
- **Insufficient engagement with companies and high cost of meeting providers' data requests.** Responding to data requests from multiple rating providers is costly. Companies may therefore prioritise responses to certain ESG rating providers, potentially leading to some market distortion.

3.26 We therefore asked:

Q17: ***Do you agree with how we have characterised the challenges and potential harms arising from the role played by ESG data and rating providers? If not, please explain what other challenges or harms might arise?***

3.27 A significant majority of the 40 respondents agreed with the challenges and potential harms we identified.

3.28 In addition to the potential harms identified, some respondents commented on the quality of ratings. Some were concerned by the backward-looking nature of many ESG ratings and by the low frequency of (annual) sustainability disclosures on which most ratings rely. It was also noted that a significant number of ratings focus purely on risks without accounting for potential opportunities.

3.29 Some also questioned the depth of knowledge of ESG rating providers' analysts. It was noted that some analysts cover a significant number of rated entities for cost efficiency reasons.

3.30 Several respondents also mentioned potential market power issues arising from market concentration due, in part, to rated entities' deprioritising data requests from smaller rating providers.

3.31 Some asset managers also highlighted the high costs – partly driven by asset owners' requests to use specific providers and by product bundling (such that asset managers are unable to purchase only the specific ESG data or rating product that they are interested in).

3.32 Many respondents acknowledged that they expect to see improvements in the quality of corporate ESG data once the ISSB sets a global corporate reporting baseline for sustainability matters. While some challenges would remain, an improvement in data quality could, in turn, enhance the quality of ESG ratings.

Guidance for users

3.33 To address the potential harms identified, we set out a range of different policy actions that could be considered, including regulatory guidance on existing Handbook requirements for users of ratings.

3.34 We asked:

> **Q18:** ***Would further guidance for firms on their use of ESG ratings – and potentially other third-party ESG data – be useful, potentially clarifying expectations on outsourcing arrangements, due diligence, disclosure and the use of ratings in benchmarks and indices? Are there other aspects such guidance should include?***

3.35 Of the 32 respondents to Q18, a clear majority saw a case to issue further guidance for firms around outsourcing arrangements, due diligence and the use of ratings in benchmarks and indices. Several respondents recommended that market participants be involved in the development of any such guidance.

3.36 High-level, principles-based guidance was explicitly preferred by many respondents. Some argued this would allow guidance to remain relevant in a highly innovative market, or that it could prevent users from adopting a compliance mindset. A few respondents preferred the inclusion of additional guidance within existing requirements on outsourcing arrangements and due diligence.

3.37 Some respondents highlighted the clear need for users to ensure they understand ratings methodologies. There was also support for guidance encouraging greater transparency of users' reliance on ESG data and rating products, and on how they assess the reliability and limitations of these products.

3.38 One respondent also encouraged the development of guidance on potential conflicts arising from the relationship between ESG data and rating providers and their financial services clients. Another noted that, while some ESG services tasks can be outsourced, the users' ultimate responsibility cannot be.

3.39 Of the four respondents who disagreed, some considered existing requirements, such as those on outsourcing arrangements and supply chain risks, to be adequate. Some noted that the FCA had already clarified its expectations in the guiding principles set out in the Dear Chair letter sent to authorised fund managers in July 2021.

3.40 In light of the observations regarding data gaps, one respondent favoured the FCA's prioritising its work on issuers' disclosures. And noting that a particular concern was the embedding of ESG ratings in benchmark indices, one respondent encouraged the FCA to require that benchmark administrators make clear and transparent disclosures of their use of ESG data and/or ratings in their methodology documents. This was considered preferable to setting specific standards or guidelines for investment firms.

Closer regulatory oversight

3.41 In addition to considering the issuance of regulatory guidance to users of ESG data and ratings, we also sought feedback on the case for closer regulatory oversight of ESG data and rating providers – by either encouraging a voluntary Best Practice Code, or engaging with the Treasury regarding an extension of our regulatory perimeter.

3.42 We asked:

> **Q19:** ***We would welcome views on whether there is a case either to encourage ESG data and rating providers to adopt a voluntary Best Practice Code, or for the FCA to engage with the Treasury to encourage bringing ESG data and rating providers' activities inside the FCA's regulatory perimeter.***

3.43 Of the 44 respondents to this question, 39 were supportive of our either encouraging providers to adopt a voluntary Best Practice Code or engaging with the Treasury to bring these providers into our regulatory perimeter. A few did not express a clear view on the matter.

3.44 Of the supportive respondents, the majority endorsed an extension of the FCA's regulatory perimeter, in preference to introducing a voluntary Best Practice Code. A principles-based approach was explicitly favoured by some, noting the importance of flexibility in an evolving market.

3.45 Several respondents noted the growing importance of ESG data and ratings to meet asset owners and asset managers' own disclosure requirements. Others expressed their concerns about embedding ESG ratings into benchmarks.

3.46 Many respondents wished to see a global approach, acknowledging the global reach of the largest ESG data and rating providers. Several of these respondents also explicitly expressed their support for IOSCO's consultation report published in July 2021. A further 10 referenced IOSCO's work without explicitly supporting the draft recommendations. We note that IOSCO's final recommendations were published after the end of our own consultation period, in November 2021.

3.47 The few respondents who held mixed views – mainly ESG data and rating providers – noted that heavy regulation could stifle innovation, and potentially act as a barrier to entry for smaller providers. This could, in turn, have adverse implications for competition. One investor did not think closer oversight was necessary at this point.

The potential shape of a regulatory oversight

3.48 To better inform our current policy thinking, we asked respondents who thought there was a case for closer regulatory oversight to give their views on the appropriate regulatory outcomes and priorities.

3.49 We asked:

> **Q20:** ***If there is a case for closer regulatory oversight of ESG data and rating providers, we welcome views on:***
>
> **a.** ***Whether transparency, governance and management of conflicts of interest are the right aspects of ESG data and rating providers' operations and activities to prioritise in regulatory oversight, and if not, what other aspects should be considered***
>
> **b.** ***Whether and how regulatory priorities should differ between ESG rating providers and other ESG data providers***
>
> **c.** ***The similarities and differences between the policy issues that arise for ESG rating providers and those that arise for CRAs, and how far these similarities and differences might inform the appropriate policy response***

3.50 Almost all respondents to Q20a. agreed that the three aspects identified should be prioritised. They saw a strong need for better transparency, governance processes and management of conflict of interest – ideally through an international approach, such as that recommended by IOSCO (see feedback received to Q19).

3.51 Some ESG rating providers specifically emphasised the need for ESG ratings to remain completely independent of third-party influences. Several respondents noted that any regulatory approach would have to accommodate appropriate protection of intellectual property.

3.52 Some of the priorities cited by respondents included the following:

- **Transparency.** Including: transparency in methodologies (eg, parameters, assumptions, metrics and weightings) and in data inputs (eg, key data sources, the approach to filling data gaps, the frequency and nature of engagement with rated entities)
- **Governance/systems and controls.** Including: responsibilities of key committees; consistency in application of processes; model governance and data handling; frequency of reviews; right to reply for rated entities
- **Conflicts of interest.** Including: public disclosure of actual/perceived conflicts and the policies to mitigate and manage them, as well as reporting on actions undertaken to meet minimum standards and establish best practices

3.53 The majority of respondents valued the diversity of opinions and approaches among rating providers, and therefore did not want to see a convergence in methodology. Some still argued low correlation remains problematic when the analysis of objective data leads to widely diverging interpretations between providers.

3.54 The views of participants were mixed regarding Q20b. Of the 26 responses to this question, slightly less than half of the respondents – mainly investors and asset owners – considered that regulatory priorities across both ESG data and rating providers should be similar, especially since users are increasingly interested in the data that sit behind providers' ratings judgements.

3.55 The other respondents believed they should be regulated differently, in some cases reflecting the view that ESG ratings could have a greater systemic impact on investment decisions, capital allocation and the market as a whole. One respondent thought ESG data providers should not be treated any differently from financial data providers.

3.56 One respondent mentioned that managing conflicts of interest was important for both types of providers. However, transparency in methodology may be more relevant to ESG rating provision, while good data hygiene and management would be the priorities for ESG data services.

3.57 Finally, most of the 22 respondents to Q20c. set out the perceived similarities and differences between CRAs and ESG rating providers, without clearly expressing a view on the potential policy implications. Several respondents favoured a different policy approach for ESG rating provision, while a few considered that a broadly similar approach would be appropriate.

3.58 Some of the differences highlighted by respondents included:

- the CRA market is mature and well-established, while ESG rating provision is still developing and innovating
- ESG ratings are multi-dimensional, while credit ratings are focussed on a single attribute; ie, credit worthiness
- credit ratings have a widely accepted definition and aim, while ESG ratings do not
- CRAs follow an 'issuer pays' model, while ESG rating providers typically have an 'investor pays' model
- CRAs issue information on what would trigger a rating upgrade or downgrade, which is not the case for ESG rating providers
- in comparison to CRAs, issuers have limited interaction with ESG rating analysts

Our response

We note the broad-based support among stakeholders for our analysis of the challenges and potential harms arising from the role played by ESG data and rating providers.

Guidance for users

We note respondents' interest in the FCA's providing further guidance for firms on their use of third-party ESG data and rating services.

As a first step, our Asset Management Supervision Department has carried out thematic work to further their understanding of the approaches authorised fund managers use to implement ESG strategies in their authorised funds.

As a next step, we will be engaging more formally with firms in the coming months on their response to our 'Dear Chair' letter, published in July 2021. This letter included a set of guiding principles for the design, delivery and disclosure of authorised investment funds that pursue a responsible or sustainable investment strategy and claim to pursue ESG/sustainability characteristics, themes or outcomes.

Specifically, key recommendation (b) under Principle 2 sets the following expectation: 'Where a firm uses ESG/sustainability research, data and analytical tools to support its fund delivery process, it should employ appropriate resources to oversee this. It should also consider due diligence on any data, research and analytical resources it relies upon (including when third-party ESG rating, data and research providers are used) to be confident that it can validate the ESG/sustainability claims that it makes'. Informed by the outcome of our supervisory engagement, we will consider whether further guidance is necessary.

In addition, as part of our work on classification and labelling of sustainable investment products, launched with DP21/4 in November 2021, we are considering including among the criteria for qualifying for a sustainable investment label the requirement that the product provider carries out appropriate due diligence on any sustainability-related data, research and other analytical resources that it relies upon.

We may consider whether further steps are necessary to extend such expectations to the use of third-party data and rating services beyond the management of products that will fall within the scope of our proposed rules on classification and labelling.

Closer regulatory oversight

We note the clear feedback received and the broad support for our description of the growing and pervasive role of ESG data and rating providers, and potential harms relevant to our objectives.

Given these potential harms, and the benefit to wider market functioning of an effective, trusted and transparent market for ESG data and ratings, we see a clear rationale for regulatory oversight of certain ESG data and rating providers – and for a globally consistent regulatory approach informed by IOSCO's recommendations on ESG data and ratings.

As noted, the Government is considering bringing ESG data and rating providers within our regulatory perimeter. We will therefore continue to work closely with the Treasury on this topic.

Potential shape of a regulatory oversight
Should ESG data and rating providers be brought within our regulatory remit, we would develop a proportionate, targeted and phased approach to regulation in this area.

In determining a proportionate scope for such a regime, we would expect to take into account factors such as the size of the provider, the degree of judgement and 'value-added' in its service provision, and the nature and degree of usage of the provider's services in the market.

We note the clear support from stakeholders for prioritising matters related to transparency, governance and management of conflicts of interest in any regulatory regime. These matters are well aligned with the priorities for regulatory oversight identified in IOSCO's recommendations last November. We therefore consider that the design of any regulatory approach would be based on the main elements of these recommendations.

Such an approach would therefore aim to:

- enhance **transparency** of ESG ratings and data products and their methodologies, assisting users in interpreting what they aim to measure and how, and
- promote **strong governance, conflicts management**, and **systems and controls** to underpin data and rating products and give the market confidence that they are objective, independent and free from bias, determined as the result of a systematic process, and of reliable quality

Figure 5 below maps some of the key elements of IOSCO's recommendations to these four pillars – in particular, Recommendation 1 for regulators and associated guidance (3rd bullet point on page 36). Recommendation 2 also sets out procedures ESG data and rating providers could consider to promote the issuance of high quality products. Recommendation 5's guidance notes ESG data and rating providers could consider, when providing information on the methodology of their products, publishing the measurement objective of such products. In addition, Recommendations 8 and 9 suggest ways in which ESG data and rating providers may consider interacting with entities subject to their assessment.

These recommendations capture some of the key regulatory outcomes that we would expect a regulatory regime to achieve. We would expect this to lead, in turn, to better information for investors to make their investment decisions, enhanced market integrity through high quality information, and more effective competition through better comparability of products.

Figure 5: IOSCO's recommended key regulatory outcomes

Transparency	Good governance	Management of conflicts of interest	Robust systems and controls
• Methodologies (incl. individual underlying components, measurement objective) • Data and information sources (incl. whether public) • Procedures for data gaps, and the use of averages and estimates	• Enabling good management of conflicts of interest • Internal consistency of methodology within a provider • Sufficient resources and competent personnel	• Identification, mitigation, management and disclosure of conflicts of interest	• Written policies and procedures and/or internal controls on processes and methodologies • Facilities for reporting of complaints and misconduct (incl. on independence, transparency and integrity) • Engagement with rated entities

Given the potential lead time before any such regime could come into force, and as suggested by IOSCO, we would also work – in the interim – with the Treasury to convene, support and encourage industry participants to develop and follow a voluntary Code of Conduct, addressing matters similar to those listed above and reflecting the content of IOSCO's recommendations. The voluntary Code could also build on and supplement the principles for service providers set out in the UK Stewardship Code 2020. Such a voluntary Code could potentially continue to apply for ESG data and rating providers that fall outside the scope of any future regulatory regime.

Sustainable finance in wider capital markets

3.59 Elsewhere in CP21/18 (Chapter 3), we asked whether it might be desirable to extend climate-related disclosure requirements to issuers of listed debt and debt-like securities. Our proposed TCFD-aligned Listing Rule had not been applied to this listing category.

3.60 We received generally supportive responses and provided high-level feedback on this matter in our Policy Statement PS21/23 last December. We agreed that there was a case to consider introducing some form of disclosure requirements for debt and debt-like securities. However, we also acknowledged that this should be through a tailored approach, rather than by extending the form and structure of our existing Listing Rule on climate-related disclosures.

3.61 Separately, in the discussion chapter of CP21/18, we also acknowledged that ESG-labelled debt instruments, and ESG data and rating providers are by no means exhaustive of all relevant ESG issues in capital markets.

3.62 We therefore asked:

> **Q21:** ***What other ESG topics do you consider that we should be prioritising to support our strategic objective? Please explain.***

3.63 Several respondents explicitly supported our prioritising issues related to ESG-labelled debt instruments and ESG data and rating providers.

3.64 Some additional points were raised that are relevant to these issues. For instance, one respondent urged the FCA to consider regulatory incentives for the holding and/or issuance of green bonds. Several respondents thought increased scrutiny on SLB issues could also be useful, as the challenges in assessing and verifying their KPIs and KPTs could result in greenwashing and legal disputes. One also suggested giving consideration to prospectus disclosures of ESG impacts.

3.65 However, most respondents proposed that we also consider regulatory actions in other areas. A number of points were raised regarding climate-related and wider sustainability-related disclosures, with respondents variously encouraging us to:

- extend our climate-related disclosure requirements to cover other sustainability themes, such as biodiversity and social matters, and increase the emphasis on quantitative metrics
- standardise the format of climate-related disclosures to promote machine-readability and ease of access to the data
- provide guidance on good disclosure practices and promote the audit and assurance of climate-related disclosures
- set a clear path to increase transparency on ESG-related matters along the investment chain, including measures to protect consumers, such as fund labelling and UK regulation on the lines of the EU's Sustainable Finance Disclosures Regulation (SFDR).

3.66 A number of respondents indicated their strong preference for global alignment of regulatory approaches, including on green bond standards, ESG data and rating providers, and reporting frameworks and taxonomies. One respondent mentioned the benefit of engaging with standard-setting organisations, such as the International Organization for Standardization (ISO) and the IFRS Foundation.

3.67 One respondent suggested assessing current global standards in order to remove regulatory barriers and to add appropriate incentives for the financing of activities aligned with the Paris Agreement and United Nation's Sustainable Development Goals.

Our response

We note the range of topics respondents suggested us to prioritise, reflecting the importance of ESG topics in capital markets. Taking a cross-cutting and holistic approach (see Chapter 4), our ESG Strategy addresses a number of the suggestions received:

- The Government's Roadmap to Sustainable Investing elaborates on plans to introduce a sustainable investment labelling regime that makes it easier for consumers to navigate the range of investment products available to them. As a first step towards delivering this ambition, we published a discussion paper (DP21/4) seeking feedback on the shape of the regime, ahead of consultation in the coming weeks.
- As part of our work on implementing TCFD-aligned disclosures for listed companies and FCA-regulated asset managers and asset owners, we are collaborating with the FRC on targeted 'deep dive' thematic work to highlight how reporting against our climate-related disclosure rules is evolving in practice. Separately, the FRC has developed a digital reporting taxonomy to tag TCFD-aligned financial disclosures.
- Through our involvement at IOSCO, we continue to actively support the development by the ISSB of a robust sustainability-related corporate reporting standard that can serve global markets effectively. We note that this baseline will go beyond climate, encompassing disclosure requirements on wider sustainability matters relevant to preparers' future enterprise value. In our work with IOSCO, we are also examining in parallel the framework for audit and assurance of sustainability reporting. Separately, the ISSB recently published a staff request for feedback to inform the future development of a disclosure taxonomy that would ensure the machine-readability of companies' sustainability disclosures.
- We will continue to promote globally aligned solutions where possible. This includes having regard to relevant IOSCO recommendations, such as those referenced elsewhere in this FS on ESG data and ratings.

Separately, with respect to issuers of listed debt and debt-like securities, we noted in PS21/23 the need for a tailored approach to improve the availability of climate-related information. We will consider the best way to strengthen and promote transparency on climate-related representations by debt issuers, including in the context of the Treasury's Prospectus Regime Review.

4 Our policy actions and potential future direction

4.1 Having reflected on the feedback received, Figure 6 summarises the key policy actions we are taking, and the potential future direction across different market activities and services.

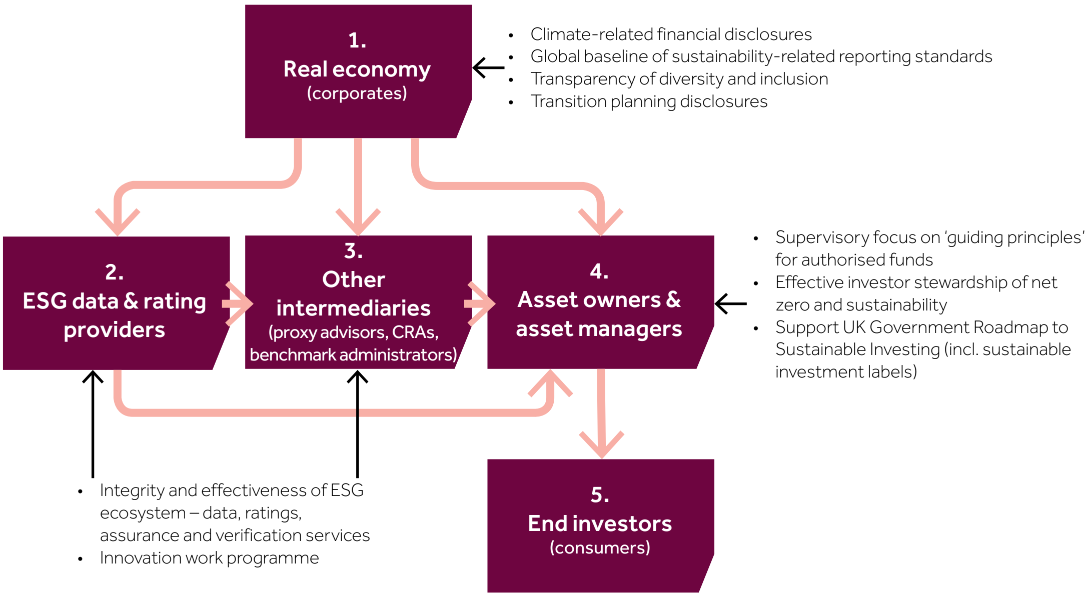
Figure 6: Our key policy actions and potential future direction

Policy actions	Advertisements, bond frameworks and prospectuses, and existing industry standards	• We remind issuers, their advisors and other relevant market participants of their existing advertisement obligations (PMB 41) • Where advertisements do not meet our expectations, we will consider the case for market oversight or enforcement actions • We encourage issuers and their advisors to consider relevant industry standards, such as the ICMA Principles and Guidelines for green, social, and sustainability bonds, when issuing ESG-labelled debt instruments
Policy actions	Verifiers and SPO providers	• We encourage issuers to consider relevant industry standards, such as the ICMA Guidelines for External Reviews, when selecting their SPO providers and verifiers. We also encourage verifiers and SPO providers themselves to consider voluntarily applying these guidelines
Policy actions	ESG data and rating providers	• We see a clear rationale for regulatory oversight of certain ESG data and rating providers – and for a globally consistent regulatory approach informed by IOSCO's recommendations on ESG data and ratings • We will continue to work with the Treasury, who are considering bringing ESG data and rating providers within our regulatory perimeter
Potential future direction	Bond frameworks and prospectuses, and bond standards	• As part of the Treasury's wider Prospectus Regulation Review, we may reassess in the future, with the Treasury, the case to develop an appropriate standard for UoP bonds
Potential future direction	Verifiers and SPO providers	• We may consider further, with the Treasury, the case for regulatory oversight of these service providers in the future
Potential future direction	Climate-related disclosures for listed issuers of debt	• We will consider the best way to strengthen and promote transparency on sustainability representations by debt issuers, including in the context of the Treasury's Prospectus Regime Review
Potential future direction	ESG data and rating providers	• If the Treasury extends our regulatory perimeter, we will take the necessary steps to develop and consult on a proportionate and effective regulatory regime for ESG data and rating providers: ◦ with a focus on outcomes in areas highlighted in IOSCO's recommendations, such as transparency, good governance, management of conflicts of interest, and systems and controls ◦ given the potential lead time before any such regime could come into force, we would – in the interim – work with the Treasury to convene, support and encourage industry participants to develop and follow a voluntary Code of Conduct addressing matters similar to those listed above ◦ we would consider whether such a voluntary Code could continue to apply for ESG data and rating providers that fall outside the scope of any future regulatory regime

4.2 Considering the complex interactions across the ESG data ecosystem – as set out in Chapter 2 – we recognise the need for a holistic, cross-cutting approach to assessing potential harms and building trust and confidence. Figure 7 summarises some of the key areas of focus in our ESG Strategy that will contribute to building trust and integrity in the ESG data ecosystem.

4.3 For instance, in addition to the matters considered in this FS regarding the provision of ESG data and rating services (point 2), we are engaged in ongoing work to improve the flow of information from the real economy into the financial sector (point 1), as well as to regulate the design, delivery and disclosure of sustainable investment products (point 4).

Figure 7: The areas of focus in our ESG strategy



Annex 1
CP21/18 discussion chapter questions

Q12: **If future changes were considered in relation to the UK prospectus regime, we would welcome views on also taking the opportunity to introduce specific requirements in relation to UoP bond frameworks and their sustainability characteristics?**

Q13: **Should the FCA explore supporting the UoP bond market by recognising existing standards (eg, ICMA Principles), potentially through our recognition of industry codes criteria and process?**

Q14: **We would also welcome views on more ambitious measures the FCA could consider, for example to require that the central elements of UoP bonds be reflected in contractual agreements and set out in the prospectus.**

Q15: **We would welcome views on the potential harm set out above and what, if any, actions the FCA or the Treasury should consider.**

Q16: **Should the FCA, alongside the Treasury, consider the development and creation of a UK bond standard, starting with green bonds?**

Q17: **Do you agree with how we have characterised the challenges and potential harms arising from the role played by ESG data and rating providers? If not, please explain what other challenges or harms might arise?**

Q18: **Would further guidance for firms on their use of ESG ratings – and potentially other third-party ESG data – be useful, potentially clarifying expectations on outsourcing arrangements, due diligence, disclosure and the use of ratings in benchmarks and indices? Are there other aspects such guidance should include?**

Q19: **We would welcome views on whether there is a case either to encourage ESG data and rating providers to adopt a voluntary Best Practice Code, or for the FCA to engage with the Treasury to encourage bringing ESG data and rating providers' activities inside the FCA's regulatory perimeter.**

Q20: If there is a case for closer regulatory oversight of ESG data and rating providers, we welcome views on:

a. Whether transparency, governance and management of conflicts of interest are the right aspects of ESG data and rating providers' operations and activities to prioritise in regulatory oversight, and if not, what other aspects should be considered

b. Whether and how regulatory priorities should differ between ESG rating providers and other ESG data providers

c. The similarities and differences between the policy issues that arise for ESG rating providers and those that arise for CRAs, and how far these similarities and differences might inform the appropriate policy response

Q21: What other ESG topics do you consider that we should be prioritising to support our strategic objective? Please explain.

Annex 2
List of non-confidential respondents

Alternative Investment Management Association/Alternative Credit Council (AIMA/ACC)

ARC Ratings UK Limited

Association for Financial Markets in Europe (AFME)

Association of British Insurers (ABI)

Association of Investment Companies (AIC)

Association of Real Estate Funds (AREF)

Baillie Gifford & Co

Barclays

Bloomberg

Brewin Dolphin Limited

CDP

CFA UK

City of London Law Society (CLLS)

ClientEarth

Deloitte

EcoVadis

Federated Hermes

FIA European Principal Traders Association (FIA EPTA)

Fin-X Solutions

ICE Data Services

IHS Markit

Impact Investing Institute

Index Industry Association (IIA)

Institute of Chartered Accountants in England and Wales (ICAEW)

Institutional Investors Group on Climate Change (IIGCC)

Institutional Shareholder Services (ISS)

Interactive Investor

International Capital Market Association (ICMA)

International Organization for Standardization's Climate Change Coordination Committee and Technical Committee 68 (ISO CCCC and ISO TC68)

Invesco

London Stock Exchange Group (LSEG)

M&G

Moody's

Morningstar

MSCI

Nest Corporation

Quoted Companies Alliance (QCA)

S&P Global

Schroders

ShareAction

Standard Chartered

The Investment Association (IA)

UK Finance

5 respondents requested their answers to be treated as confidential. We have also decided to treat the 2 responses from individuals as confidential.

Annex 3
Abbreviations used in this paper

Abbreviation	Description
CBI	Climate Bonds Initiative
CP	Consultation Paper
CRAs	Credit Rating Agencies
DP	Discussion Paper
ESG	Environmental, Social and Governance
ESMA	European Securities and Markets Authority
EU	European Union
FRC	Financial Reporting Council
FS	Feedback Statement
GBS	Green Bond Standard
IAASB	International Audit and Assurance Standards Board
ICMA	International Capital Market Association
IESBA	International Ethics Standards Board for Accountants
IOSCO	International Organization of Securities Commission
IRSG	International Regulatory Strategy Group
ISO	International Organization for Standardization
ISSB	International Sustainability Standards Board
KPIs	Key Performance Indicators
PMB	Primary Market Bulletin
PRR	Prospectus Regulation Rules
PS	Policy Statement

Abbreviation	Description
SFDR	Sustainable Finance Disclosures Regulation
SLBs	Sustainability-Linked Bonds
SPO	Second Party Opinion
SPTs	Sustainability Performance Targets
TCFD	Taskforce on Climate-related Financial Disclosures
UK	United Kingdom
UoP	Use of Proceeds

All our publications are available to download from www.fca.org.uk. If you would like to receive this paper in an alternative format, please call 020 7066 7948 or email: publications_graphics@fca.org.uk or write to: Editorial and Digital team, Financial Conduct Authority, 12 Endeavour Square, London, E20 1JN

Pub ref: 007873

12 Endeavour Square London E20 1JN
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk