Frankfurt,
11 March 2022

BVI[1] reply to the ESMA Call for Evidence on Market Characteristics for ESG Rating Providers in the EU

(https://ec.europa.eu/eusurvey/runner/callforevidenceonESGratings)

Question Please select your category:*

☐ ESG Rating Provider
☒ ESG Rating User
☐ Entity covered by ESG Rating Providers

Questionnaire B- ESG Rating Users

1. Background information

Question 1 Name of respondent or organisation (including Legal Entity Identifier where applicable).*

BVI Bundesverband Investment und Asset Management e.V., LEI: 3912009PXS1ND1QZW308

Question 2 Nature of establishment in EU Additional help available

☒(A) Legal entity established in EU (please indicate Member State(s) of legal entities)
☐(B) Legal entity and corporate headquarters established in EU (please indicate Member State for each)
☐(C) No legal entity or corporate headquarters established in EU (please indicate country of corporate headquarters)
☐(D) Other (Please explain)

If you answered Q.2, please explain:

BVI is a non-profit trade organization based in Germany which represents the interests of the German fund industry at national and international level- BVI's ID number in the EU Transparency Register is 96816064173-47 and its LEI is: 3912009PXS1ND1QZW308.

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset Managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 116 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 27%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

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Question 3 Respondent subject to any existing financial regulatory authorisation, registration or supervisory regime.

☐Yes
☒No

If you answered Yes to Q.3, please provide further details of the regime including name of authorisation, registration or supervisory body and reference to supporting legal acts.

Question 4 General description of business model and main area of economic activity

Please see FN 1.

Question 5 Estimated total value (in EUR) of administrated assets and/or asset under management (if applicable). [For currency conversions to EUR, please use ECB reference exchange rates available here: https://www.ecb.europa.eu/stats/policy_and_exchange_rates/euro_reference_exchange_rates/html/index.en.html]

N/A - BVI's 116 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 27%, Germany represents the largest fund market in the EU.

Question 6 Estimated total value (in EUR) of investments for which ESG rating and/or other ESG data products are used as input in investment decision making process (if applicable).

BVI's 116 members manage assets of some EUR 588 billion Euros marked as funds with sustainability characteristics for which ESG rating and/or other ESG data products are used as the main input in investment decision making process.

2. Use of ESG ratings (if applicable)

Question 1 Currently contracting for ESG ratings

☐Yes
☒No

Question 2 Currently contracting for other ESG data products

☒Yes
☐No

Question 3 If you answered "Yes" to Q1 or Q2, please list the providers you contract with for each ESG rating and/or other ESG data products and identify the categories of product.

BVI uses Morningstar data for investment fund and ESG research. BVI used Sustainalytics, a Morningstar company, and ISS, a Deutsche Börse company for single research projects.

Question 4 Please provide the length of time in months which you have contracted with each provider.

BVI Morningstar data for investment fund and ESG research for more than 3 years.

Question 5 Please explain reasons behind the choice of the ESG rating or data provider(s) listed in Q3.

Morningstar group is offering general fund data and fund related ESG data.

Question 6 Please explain reasons for choosing more than one ESG rating provider (if applicable).

Choosing the adequate data provider is depending largely on the data and analytics made available by the provider in comparison with the specific questions on the ESG issue which is to be researched.

Question 7 In case you changed ESG rating provider, please provide the rationale behind the choice.

Question 8 Please outline and explain any shortcomings in the ESG rating or ESG data products you currently contract for.

Environmental, social, and governance (ESG) investing is a very broad field with many different investment approaches addressing various investment objectives. At a top level, we can break down ESG investing into three main investment approaches: ESG integration, in which the key objective is to improve the risk–return characteristics of a portfolio; second, values-based investing, in which the investor seeks to align his portfolio with his norms and beliefs; Third, impact-related investing, in which investors want to use their capital to trigger change for social or environmental purposes, for example, to accelerate the decarbonization of the economy. All approaches need a wealth of ESG data and analytics. Within the EU, under SFDR, Article 6, 8 & 9 funds are likely to use ESG inputs to varying degrees. Article 6 funds are only required to consider ESG risks as part of the normal portfolio risk process, rather than having specific ESG objectives, and are therefore likely to use fewer ESG inputs versus Article 8 or 9 funds for which ESG outcomes are central to the investment strategy.

Asset managers need to refer to internal and/or external research for analysing sustainability risks and implementing the relevant ESG investment strategies. According to a membership survey, most BVI members build their sustainability data basis upon ESG ratings, followed by labels, benchmarks and other standards (such as ISO).

Sustainability and climate-related data and scores available in the market suffer from a lack of standardisation and comparability. This also applies for the integration of ESG factors into credit ratings by credit rating agencies (CRAs). Even though there has been some improvement regarding the overall availability of ESG data in the last years, the persisting lack of comparability and reliability has still fundamental implications for data users, i.e. investors, companies and researchers. Directly reported company data is generally not usable in practice due to the lack of comparable and standardized data, a single access point and the necessity to perform quality checks on the reported information. This gap is currently being filled by commercial data vendors experiencing rapidly growing business opportunities parallel to the increasing regulatory requirements for the processing of ESG data for the purpose of internal processes (risk management, investment due diligence) and external client and regulatory reporting by financial market participants. Indeed, market concentration in the ESG data business has significantly increased over the last years, in particular due to strategic acquisitions. All leading ESG data and research providers (such as MSCI, Morningstar - which acquired Sustainalytics in 2020, and Vigeo-Eiris, the biggest according to market share) are now either headquartered in the US or owned by US company groups with the exception of ISS ESG that belongs to the Deutsche Börse group. This situation may become problematic in a twofold respect:

- It may **have implications for the quality and reliability of data**, if European investors and financial market participants needed to rely on ESG research and qualitative assessments of ESG aspects as basis for ESG ratings that might not fully incorporate and take into account the development of the EU sustainable finance regulations. This is particularly relevant in relation to investments outside the EU, where EU investors will most probably not be able to refer to corporate disclosures, since such disclosures will not meet the EU requirements. This potential outcome cannot be deemed satisfactory from a general policy perspective.

- It may **further strengthen the pricing and licensing power of ESG data providers**. In the last years, data providers have overloaded the market with their products. The pricing frameworks remain opaque, depending largely on the combination of data modules and the size of (ESG) assets under management of the client. A mid-sized to large fund manager will spend between EUR 200,000 and 400,000 per year for a comprehensive set of ESG data. Given that the amount of required data will grow in view of the pending implementation of ESG disclosure duties, we expect this cost to rise substantially in the future driven by global regulation. Additional cost for acquisition of EU-Taxonomy-relevant data can be estimated with EUR 50,000 for the currently required set of indicators. These expenses represent a significant burden especially for small and medium-sized asset managers and asset owners such as pension funds. More competition in the ESG data market would be helpful for raising efficiency as well as product quality and lowering costs.

In practical terms, our members report the following shortcomings in the data services they contract for:

- **Lack of transparency with regard to ESG rating methodologies** (forward-looking perspective), in particular concerning procedures for unscheduled adjustments of ratings during the year (e.g. due to controversies),
- Changes to the applied rating and ranking methodologies are sometimes not being made transparent nor consulted with clients beforehand,
- There is often a **significant time lag concerning the ESG data** that underlie ESG rating/rankings or scores which is due in part to the 12 months period for corporate sustainability reporting, but in another part to suboptimal handling processes by the data vendors, thus adding up to the problem of using potentially outdated information.

Question 9 Please outline whether you are satisfied with the level of methodological transparency for the products you contract for, including transparency around data sourcing.

According to academic studies, the main issues with ESG rankings and ratings seem to be systematic differences between methodologies of data providers regarding the indicators they use to measure ESG factors as well as their weights and scope (see for example, „Aggregate Confusion: The Divergence of ESG Ratings“, MIT Sloan School of Management, August 2019). This implies that the investment decisions made upon these scores might be biased. Therefore, full transparency is needed about the rating/scoring methodologies, including a description of the underlying data and data sources used by data providers.

Methodological transparency with regard to ESG ratings/scorings is of even higher relevance than in relation to traditional credit ratings. This is because there is no universal concept of sustainability and each and every provider focuses on different aspects or attaches different weightings to the environmental, social and governance indicators. While this competition of concepts is welcomed in principle, it entails more responsibility for the users of ESG ratings to understand the rationale of each assessment in order to properly match it with the stated investment objectives of the fund and to feed it into the internal analysis and investment process.

According to the feedback from our members, the level of methodological transparency is still not satisfactory. **We request comprehensive disclosure of the rating/ranking methodology applied, including procedures for unscheduled adjustments of ratings during the year (e.g. due to controversies). Changes to the methodologies should also be made transparent and consulted beforehand with clients, as in the case with credit rating methodologies under the CRAR.**

As regard the general public, it is important to **increase awareness about the purpose and limitations of ESG ratings or scores**. While ESG ratings aim to inform about the level of sustainability risk associated with an investment, i.e. the impact of sustainability-related events on the prosperity of a company, they seem to be perceived by many as measure of sustainability. Given the growing interest in sustainable investments, it is important to avoid misperceptions in this respect, especially among retail investors.

Transparency about data sourcing and the methods used on filling of data gaps is insufficient as well. However, such transparency will be key for complying with the EU reporting requirements especially in relation to the EU Taxonomy and the principal adverse impacts (PAIs). Given that under the SFDR RTS financial products shall be only allowed to rely on third-party data for calculating their proportion of Taxonomy-aligned investments if such data is either reported by companies under Article 8 Taxonomy Regulation or qualifies as “equivalent information”, it will be of **key relevance for the user community to distinguish data obtained or derived from companies’ disclosures from other data points based especially on estimations or extrapolations, such as ESG benchmarks established on certain industry sectors within the economy.** ESG data providers should take immediate steps to ensure this basic level of transparency about data sources.

Question 10 If no to Q.1 and Q.2, please list ESG rating and/or other ESG data products providers you are currently using.

N/A

Question 11 Please outline and explain any shortcomings in the ESG rating or ESG data products you are currently using on a non-contractual basis.

Please see our answer to Q8/9.

Question 12 Please outline whether you are satisfied with the level of methodological transparency for the products are currently using on a non-contractual basis.

No, please see our answer to Q8/9.

3. Contractual Characteristics

Question 1: If you currently contract for ESG rating or ESG data products, please briefly describe the terms of use of your ESG rating provider, including:

Time horizon of the contract:

- Please provide details of break clauses and frequency of renewal.

Financial sustainability / ESG data providers like other data vendors usually require non-disclosure of the terms and conditions within their license contracts. Therefore, we can only answer in general terms as follows.

Asset managers are required by regulation such as AIFMD, UCITS, MiFID, SFDR and the EU Taxonomy regulation to directly or indirectly use sustainability data. These regulatory requirements help data providers in that space to build a dominant market position and to create an oligopoly or in rare case a monopoly position on certain data and analytical approaches.
ESMA should strongly recognize that large sustainability data providers, such as MSCI, Morningstar, ISS, hold disproportionate market power on data generated from company information. As such, sustainability data costs (the data pricing, licensing practices, definitions, audit procedures and connectivity fees) must be subject to regulatory oversight. Rigorous supervision of the entire sustainability / ESG data business (as well as contiguous markets and products where the search for revenue could shift once there is increased scrutiny of sustainability / ESG data sales) is crucial in order to maximize the economic and social benefits of the use of ESG data. Authorities should consider developing a cost benchmark for producing and distributing such data. In the parallel case of sustainability / ESG data such cost benchmark has been recommended in the Copenhagen Economics reports from 2013, 2014, 2018 and 2019 and the IEX exchange sustainability / ESG data cost report (January 2019) provides a practical use case.

The core principles of policy intervention should comprise the following:
1. The price of sustainability data and connectivity – like other regulated market data – should be based on the costs of producing and distributing the data (as opposed to the value market participants derive from sustainability / ESG data) with a reasonable mark-up. The cost should be measured against a recognised cost benchmark.
a) Regulators should require sustainability /ESG data vendors to submit detailed cost and revenue data reports in order to understand the amount of mark-up they charge similar to what market data vendors / exchanges impose on users under MiFIR rules.

b) As sustainability / ESG data should be based on cost with a potential reasonable mark-up, data vendors should simplify contract terms and eliminate complicated usage categories which are based on the perceived value of services using ESG data.

2. Financial sustainability, including ESG data providers, should standardize key sustainability / ESG data contract definitions, terms and interpretations. Contract definitions, terms and policies should be specific and avoid overly broad or general terms. Sustainability / ESG data licensing contracts should avoid especially so-called “derived data” terms, which are lopsided and unfair to users. Standardized agreements should be subject to regulatory review.

3. Sustainability / ESG data licensing contracts should be simplified to ease administration and so that audits are not necessary.

As a further alternative, we encourage the EU to also engage with the relevant Competition Authorities to tackle the monopolistic market behaviour of some of the ESG data vendors or benchmark providers. Sustainability / ESG data vendors increase constantly worldwide their dominant positions in their respective market segments, which facilitate by ever-increasing prices (Price Policy) and incremental licensing (Data Policy) requests. As sustainability / ESG data vendors are by nature monopolies in the provision of their own sustainability / ESG data, we believe that to provide data on a reasonable commercial basis, sustainability / ESG data fees should have some relation to the cost of production of the data. The existence of monopolies at the data source level is not an issue but the abuse of a dominant position by those monopolies is a problem. On the consumer side, the market is inelastic, as the buy-side cannot simply reduce data consumption in response to price increases.

The issues that face market participants with respect to dominant data providers are:

- driving up the costs of sustainability / ESG data in a way not clearly linked to their costs of supply.
- imposing restrictions on what downstream use can be made of sustainability / ESG data without further payments. For example, certain data providers charge market participants relatively new separate “created works” or “derived data” licenses based on use of data to create (e.g., through mathematical or other manipulations or processes) new data. Data providers, however, clearly do not have any production costs associated with a market participant’s created works/derived data.
- creating a significant bureaucracy and cost around data licensing through multi-tiered licensing with variations by dataset without standardisation between vendors.

The existence of monopolies combined with the regulatory mandates to use sustainability / ESG data means that market participants have little or no leverage in negotiations with their providers).
Also, data vendors passing on sustainability / ESG data usually do not protect the end-user client through data source authorisation, e.g. by identifier or classification firms, but enforce their policies without due consideration of the impact on the clients after an alleged incident or the claims of data sources. For example, Bloomberg routinely threatened clients with US-ISIN data of cut-off at the request of S&P CUSIP without requiring any check or proof of insufficient licensing. Similar data cut-off could occur with sustainability / ESG data vendors following data license disputes. In the absence of market power, regulators and policymakers need to intervene to block such market power abuse by the sustainability / ESG data vendors to ensure the desired benefits of sustainability driven policies. That the behaviour of the (perceived) data monopolies or oligopolies is facing increased scrutiny by the competition authorities, however, is not sufficiently fast and only covering individual cases. Therefore, these negative impacts of the data oligopolies or monopolies clearly call for detailed regulation of dominant position-backed activities and oversight on these entities also by the securities regulators. We believe that the following factors should be considered:

•	Transparent, clear, unambiguous and reasonable sustainability / ESG data policies, including audit terms
•	Transparent, clear, unambiguous price information, including comparison with past years' prices
•	Cost of production: Sustainability / ESG data definition of costs is lacking and therefore it is impossible to compare and for Competent Authorities to ensure enforcement. A cost benchmark which shows the costs that may be included, and which may serve as a benchmark and a tool for supervisors in their assessment on what is reasonable and whether the Sustainability / ESG data vendors and other data providers comply with the requirements.
•	Availability of machine-readable data without restriction in access
•	Usage of IP free identifier for Issuer (LEI), financial instruments (ISIN) and classifications such as the ISO CFI, ICB or GICS.

Products included in contract:

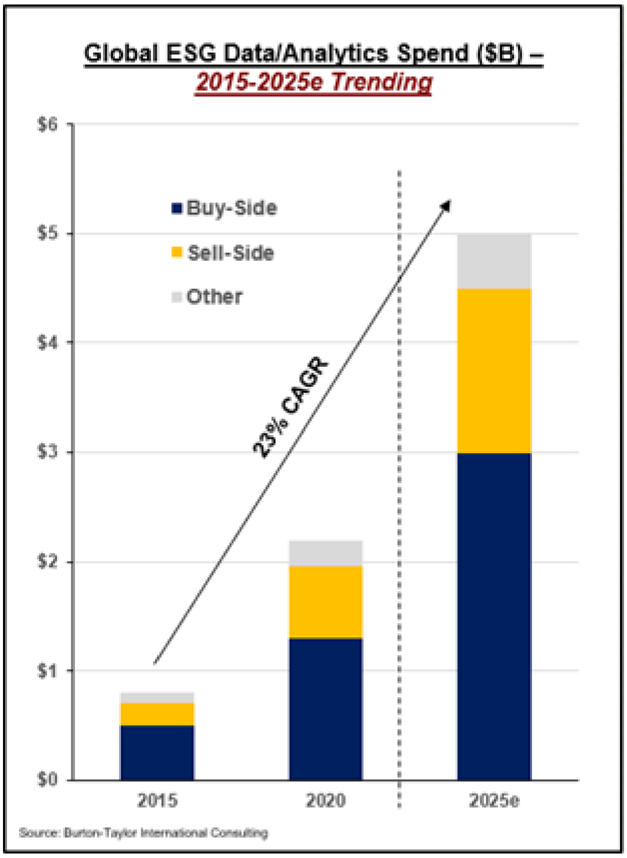
- Please outline if the contract covers a single product offering or a package of product offerings.
- Please outline if products were available only under the form of packages of multiple service and/or products.
- Please provide a more specific description of the products including their intended area of focus.

Financial sustainability, including ESG data providers, usually require non-disclosure of the terms and conditions within their license contracts. For our general comments see Q1 on time horizon of contract.

The fees structure for contracted products:

- Please outline if there is a flat fee for each product offering, or discount for bundled offerings.
- Please outline the main characteristics of the fee structure, including frequency and transparency of revisions.

Financial sustainability including ESG data providers, usually require non-disclosure of the terms and conditions within their license contracts. Therefore, we can only answer in general terms as follows. For our general comments see Q1 on time horizon of contract.
Our members are dissatisfied with the high price and data license cost of sustainability data. The prices and consistently above-inflation fee increases are difficult to justify as they do not reflect the true cost of supplying that data. In a practical sense, this adds costs to our members' businesses both directly via the fee increases themselves, as well as indirectly in the form of increasingly complex monitoring of sustainability / ESG data. Data fees are increased aggressively by the data (distributor) vendors because they are aware that there is often no other source for the data, and market participants are required to consume the data to satisfy e.g. reporting requirements.
The graph below from a Burton-Taylor's report, *The Increasing Role of ESG in Capital Markets: How Data Providers are Reacting to the Change* clearly shows that the global spend for ESG data/analytics for 2020 is estimated to be $2.2 billion with that figure expected to reach $5 billion in 2025. ESG data/analytics is one of the fastest growing segments of the broader financial sustainability / ESG data/analysis space, which Burton-Taylor reports totalled $33 billion in 2020, with a 5-year CAGR of 4.6%, or 23% over ten (2015 -2025) years. The majority of spend is with the buy-side (blue bar), i.e. our members.



Furthermore, by requiring potential users of their data to describe in detail the intended use case and often general business model as a precondition to a contract and overall interacting more and directly with data consumers, ESG data vendors can start to understand client data usage, allowing them to more easily identify even more sustainability / ESG data revenue opportunities. Analysis by the consultant TRG Screen suggests that connecting directly with data consumer clients can result in growth in financial information service revenues of between 12% and 24% on top of the large returns generated already today.[2] The example of market data can be easily repeated with sustainability / ESG data. As a result, overall revenue situation of sustainability / ESG data vendors is going through the roof, and by far exceeding operating margins of banks and other market participants.

Any usage limitations (e.g. use of ratings, access to ESG ratings, time restrictions, others):

- Please outline if there are any usage limitations placed on the products which are contracted for, for example, ability to disclose or share with third parties.

Financial sustainability / ESG data providers, including ESG data providers, usually require non-disclosure of the terms and conditions within their license contracts. For our general comments see Q1 on time horizon of contract.
Also audits on market data contracts have become so aggressive and time consuming that our members have put extensive and seemingly excessive measures in place to ensure compliance and avoid any audits. Audit by data vendors is perceived by our members as a third revenue generation source besides pricing and license policies. Increasingly sustainability / ESG data vendors like other data suppliers' resort to a form of precontractual audit by requiring potential users of their data to

[2] A-Team-Group, TRG-Revenue-Management-Report, January-2021

describe in detail the intended use case and often general business model as a precondition to a contract. The user provides information that enables the vendor, which may be an exchange as well as other monopolistic or oligopolistic users of such statement of use (SoU) to misuse their dominant market power to be able to offer new, often competing products and services, based on the in-depth level of insights into their client business which would not be possible in an at arms-length business relationship.

4. General views on ESG ratings in EU Financial Markets

Question1 Please provide your views on the level of relevance of ESG ratings to EU financial markets and financial market participants.

Do you consider this level will increase in the coming years?

ESG ratings and ESG data in general are currently very relevant for asset managers for three major purposes: (1) management of sustainability risks associated with their investments, (2) implementation of ESG-related investment strategies and (3) compliance with regulatory reporting requirements on sustainability issues.

ESG funds need both ESG and fundamental research inputs. It's not possible to run a portfolio based on climate data alone. Managers that can demonstrate the transparent allocation of ESG and fundamental inputs at the fund level will have more competitive and sustainable products. The demand is increasing also because much of the growth of ESG funds, particularly in Europe, has come from "re-branding" funds as ESG offerings. In fact, the vast majority of today's ESG products began life as conventional fundamental funds. Morningstar research indicates the sheer scale of this very rapid transition as they count globally about 5,000 newly re-branded "ESG" funds all of which need to upscale their data, ranking and ratings procurement process to include ESG. Besides the above mentioned Burton-Taylor report, also for example Substantive Research survey report "HOW TO COMBAT GREENWASHING? FIND THE RIGHT DATA PARTNERS gives a valuable background information:

"*With global ESG assets expected to reach $53 trillion by 2025, on track to represent more than a third of projected global AUM[1], investors are now placing greater emphasis on company disclosures, ESG integration and ratings agencies. Portfolio managers and analysts have been integrating quantitative and qualitative analysis on ESG, rapidly onboarding ESG rating data to establish internal processes and align with emerging guidelines. At the same time, due to a lack of standardization of these regulations and guidelines, data vendors and asset managers are implementing a combination of the global sustainable reporting frameworks with their own internally-built structures, potentially causing confusion and risking opacity across the market. Spending on ESG data is on the rise at an annual growth rate of 20% and forecasted to approach $1 billion by 2021. Already by the end of 2016, the Global Initiative for Sustainability Ratings had counted more than 125 ESG data providers in the market. In 2018, there were more than 600 global ESG ratings and rankings. Demand for ESG-related products has skyrocketed, leading to a proliferation of participants in the ESG ecosystem attempting to supply differentiated, reliable information to meet this demand. These data providers can be categorized into: -generalist data vendors (Bloomberg or Thomson Reuters), ESG-focussed (Sustainalytics or Truvalue Labs), credit rating agencies (Moody's, S&P and Fitch), and -asset managers (RobecoSAM or Arabesque).*

Established and traditional data providers are often the go-to for asset managers looking to quickly establish credibility in the market. IHS Market's 2019 study saw a greater usage in incumbents like Sustainalytics (cited by 53% of the 85 buy-side firms surveyed) and MSCI (44%), and in 2020, Sustainability confirmed that these two providers are favored for their broad coverage. However, a single go-to rating for all investors has yet to be established and buy side firms are looking to identify and portray their own ESG-based comparative advantages and specialisms, and asset owners are becoming more demanding and analytical in their assessment of their asset managers' expertise. This all provides a growing opportunity for smaller ESG data providers with niche data or differentiated processes to penetrate the market."

Without access to comparable and reliable, high-quality data on ESG issues, asset managers will not be able to properly comply with their regulatory obligations, nor to effectively identify sustainable investment opportunities in order to implement investment strategies supporting transition to a more sustainable economy. Given the current lack of common reporting standards for companies, they have no other choice than to refer to commercial ESG data vendors and to rely on their services. While large asset management companies may have the resources to conduct internal ESG research and use external providers as sources for additional data input or verifications, this effort must not be expected from mid-sized and smaller firms who will remain largely dependent on ESG rating and data providers in the foreseeable future.

The envisaged EU policy actions on strengthening and standardising corporate sustainability reporting under CSRD and creating ESAP as a central database for ESG-related information, among others, are thus most welcomed, but will not solve the current problems in the short- to medium term. This is because CSRD-compliant reports will likely not become available before 2026 and in any case will pertain only to companies located in the EU or potentially listed on EU regulated markets. Access to ESG data for investments outside the EU will in most cases not be improved. As for the ESAP, it will be most important to ensure that sustainability reports from companies will be filed in a machine-readable format enabling easy, reliable and accurate processing of data on the user side.

Before these improvements will take effect in practice, the relevance of commercial ESG data services will likely increase in the coming years. Therefore, there is definitely a need for close monitoring of the market for ESG data in order to avoid potential systemic risks and over-reliance on external ESG ratings by investors (for specific suggestions, cf. our reply to Q2 below).

Question 2 Please provide your views on the level of risk ESG ratings currently pose to orderly markets, financial stability and investor protection in the EU.

Do you consider this level will increase in the coming years?

As explained above, the relevance of commercial ESG rating/scoring and data services is growing. In order to **avoid risks for financial stability and the orderly functioning of financial markets** stemming from these increasing dependencies, the following actions should be considered:

- **ESMA should closely monitor the increasing market concentration in the ESG data market.** Currently, the market for ESG data is dominated by a handful of dominant players most of which are headquartered in the US or belonging to US company groups (with the sole exception of ISS ESG which belongs to the Deutsche Börse Group).

- **Action should be taken to improve transparency of pricing and license frameworks as described above and assessment methodologies that should adequately reflect the future regulatory environment for sustainable finance.** Such action could be initiated by way of an open dialogue with the major data providers and must not necessarily entail regulatory intervention.

- Moreover, ESMA should collect annual information on pricing, licenses, costs and revenues per types of ESG ratings and ancillary services in addition to fees and costs for rating related products and services sold by other entities within the group. Collecting information on these items would lead to a better understanding of the services provided by rating agencies and their entities within the group. Particular attention should be paid to any "bundled services", i.e. binding purchase of ESG scores when sourcing ESG data.

- Attention should also be paid to **ESG data vendors using their market power to limit re-use of purchased ESG data, especially for the purpose of internal ESG analyses**. Financial market participants must be able to apply proprietary analysis tools and prepare internal ESG ratings by using data obtained from ESG data providers, among others ("derived data"). This is essential for limiting over-reliance on external ESG ratings and to foster analysis capacities of investors.

- Such market soundings should be extended to the market for ESG benchmarks and indexes. We are concerned that many ESG index companies have great market power and can unilaterally set contractual conditions, since their clients usually cannot easily operate their products without referring to the leading benchmarks. Given the importance of the provision of benchmark data to the well-functioning of financial markets, BVI and other associations have made a series of recommendations to ensure that benchmark data is made available to users at a fair price. The recommendations which could be implemented by the ESG data and index providers themselves are the following:

  - **Impose a cost-based licensing mechanism:** Any benchmark data license costs should in principle be based only on the incremental/ marginal cost of providing and distributing a given data service plus a reasonable profits margin.
  - **Impose transparency on costs and prices:** In order to reduce disputes related to license fees, users should have access to meaningful written information, which enables the reader to recalculate the actual costs based on the applicable pricing methods. This should include cost calculation methods as well as the guidelines on the allocation of fixed and variable costs, including the cost of third parties and the costs of the provision and distribution of benchmark data offerings.
  - **Impose best practices on high impact data licenses:** Certain high-impact benchmark data license practices, which have significant negative consequences for end clients and financial markets should be subject to stricter controls. For example, the practice of data cut off should only be applied following a court or court of arbitration judgement.
  - **Clear responsibility for index calculation errors:** There is a pressing need to hold index administrators responsible for any calculation errors and recognize how integral financial indices impact the implementation of investment management strategies - especially for index-tracking ones (like ETFs) - and how critical index quality is to their success for investors.
  - **Keep data unbundling:** The user side of benchmark sustainability / ESG data should only pay for data they are interested in rather than being forced to buy additional services. Benchmark data providers should always inform customers that the purchase of the benchmark is available separately from the purchase of additional data (for example license for constituents). Furthermore, benchmark data providers should not condition the purchase of individual

benchmarks to the purchase of a broader range of benchmarks (in which there may be little interest).

- **Improve transparency**: Data users have concerns about the inventiveness of benchmark providers in creating new use cases or categories of license. Due to a lack of standardization for license concepts, fund management companies and banks do not have the ability to compare the license models across different index providers. More transparency, such as public pricelists on all data products and services, harmonized templates and standardization of definitions of key terms and concepts used in license data agreements, would be helpful in better understanding the criteria for such use cases and the avoidance of paying several times over for the same data.

As regards **investor protection**, we see the problem of **potentially misguided perception of ESG ratings on the part of retail investors**. As explained above, ESG ratings are perceived by many as measure of sustainability, whereas in fact, they aim to inform about the level of sustainability risk associated with an investment. It is thus important to increase awareness about the purpose and limitations of ESG rating services.