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EACB feedback on the European Commission's proposal for a Regulation on Environmental, Social and Governance Ratings and Sustainability risks in credit ratings

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The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4,050 locally operating banks and 58,000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 223 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 85 million members and 749,000 employees and have a total average market share of about 20%.

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As the voice of cooperative banking in the Union, the EACB has been monitoring the work of the European institutions on the Commission's proposal for a regulation on ESG ratings. Our main reason for doing so is related to the concern that the specific features of the cooperative model and the particular governance structure of cooperative banks should be protected and properly accounted for in the Regulation.

General comments

EACB AISBL – Secretariat • Rue de l'Industrie 26-38 • B-1040 Brussels
Tel: (+32 2) 230 11 24 • Fax (+32 2) 230 06 49 • Enterprise 0896.081.149 • transparency register 4172526951-19
www.eacb.coop • e-mail : secretariat@eacb.coop

The EACB generally welcomes the Commission's proposal as it will increase reliability of the ESG ratings which inform investment decisions throughout the EU. This will enable users, investors and rated entities to take informed decisions as regards ESG-related risks, impacts and opportunities. In this sense, we welcome the requirements enhancing **transparency**, eg. obligations under Article 21 whereby ESG rating providers are to publicly disclose their assessment methodologies. While the underlying methodologies of ESG rating providers may differ, there must be transparency about the methodologies, data, results, and sub-results in the rating models.

Indeed, it is currently difficult to understand the methodology behind a specific ESG rating as ESG rating providers consider the methodologies proprietary information. Transparency would allow for predictability and consistency between input and output from ESG rating providers, which is currently lacking. Such transparency is crucial for ESG ratings to support the sustainable transformation of society and gain the necessary credibility. With the Commission's proposal, ESG rating providers based outside the EU that are already subject to foreign regulatory oversight do not have to provide additional transparency. This would allow providers such as MSCI to continue their current businesses without being affected by the regulation. Here, a level playing field for ESG rating providers operating in the EU should be ensured by subjecting them to the same requirements.

ESG rating providers should be required to clearly disclose their **level of independence** and evidence Chinese walls when needed. Similar to credit ratings, it should also be clear when a rating has been solicited (paid for). ESG rating providers should also disclose who their investors and shareholders are, adopting a look-through approach to eliminate the possibility of favouritism.

ESG ratings should be subject to **specific communication rules**. Entities should be notified when a rating is being conducted. As ESG ratings are often unsolicited, entities are not always aware of a judgment issued, or they are not involved in proper dialogue with the ESG rating providers. For the rated entity, access to the related information should be made available and free of charge. This would allow the possibility for the rated entity to highlight any potential errors. Crucially, entities should have the opportunity to discuss ratings with providers before these are made public.

As regards the handling of "controversies", which can have an immense impact on how investors evaluate an issuer, it is of high importance that controversy reports are produced with the highest professional standards and that entities have the possibility to interact with the provider of these reports to ensure a fair and informed evaluation. The current definitions and scope are not entirely clear in that respect.

We support that the proposal establishes an **independent complaints procedure** under Art. 18. Given the growing importance ESG ratings (and reports on controversies) have for investment decisions it is key that complaints be treated in a professional, independent and timely manner. The time limits for this procedure should, however, be more precisely defined. The formulations "timely and fair manner" and "reasonable period of time" leave too much room for interpretation.

We fully support that the Regulation **should not cover ratings developed in-house by financial undertakings** for their internal purposes or for providing in-house financial services and products, as this is not the topic covered by the current proposal. Introducing such requirements in the proposal at hand would only create confusion and interfere with banks' practices in a disproportionate manner.

As regards the **fees charged by ESMA** to the ESG rating providers, the EACB agrees that those fees should cover ESMA's necessary expenditure relating to supervision and work pursuant to the Regulation. We would nonetheless welcome further clarity on the calculation of those fees, given potential trickle-down costs on rated entities.

Cooperative governance

The EACB wishes to highlight the importance of taking into account the particularities of governance models (cooperative, mutuals) when it comes to assessing the "G" in "ESG". We take the view that regulation should apply proportionately depending on the size, challenges and risks faced by organisations. Crucially, **cooperative governance aspects should be properly taken into account** in the context of the proposed Regulation through a specific recital, underlining that company models such as cooperatives and mutuals should be adequately reflected in providers' methodologies. This should also be made explicit in the upcoming Level 2 legislation specifying the requirements for ESG providers' assessment methodologies.

Cooperative banks are historically built on strong values, as they were built by and for local communities according to principles of democratic governance (owned in equal parts by members), prudent management and client proximity. This still holds true today as a large part of cooperative banks in the European Union remain implanted in rural areas and are rooted in a socially positive approach.

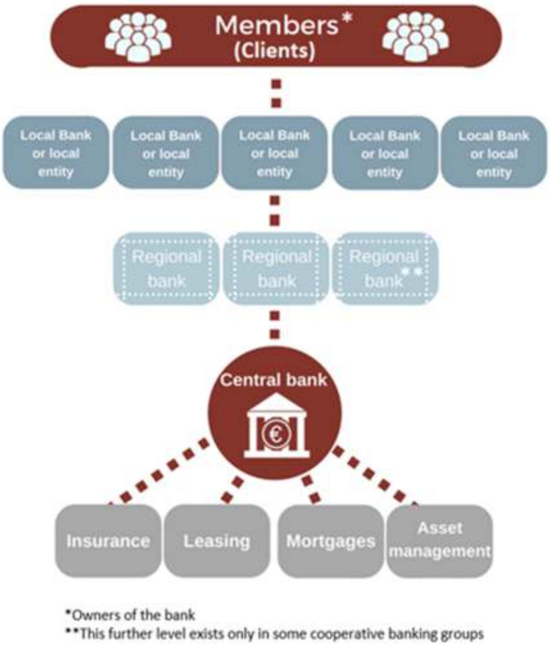
A description of the governance of cooperative banks and banking groups can be represented as per the diagram below. The diagram shows that there is a bottom-up governance which aims to provide an influence of clients that become members into the policies that cooperative banks develop.

This model ensures that these banks are guided not solely by profit, but also by investing back into communities and supporting the sustainable development of regions. They tend to remain faithful to their region even in case of economic and financial difficulties, when other banks often withdraw. While not limited to social sustainability, cooperatives provide a social business basis. This is acknowledged, to name a recent example, by the OECD in its Recommendation of the Council on the Social and Solidarity Economy and Social Innovation[1]).

Moreover, being client-owned institutions, they avoid the inherent conflict of interest between shareholders and clients that makes it difficult for other, non-cooperative companies, to focus on the long run wellbeing of all stakeholders instead of the short-term interest of shareholders.

[1] "*Social economy, also referred to in some countries as solidarity economy and/or social and solidarity economy, is made up of a set of organisations such as associations, cooperatives, mutual organisations, foundations, and, more recently, social enterprises.*" (https://legalinstruments.oecd.org/en/instruments/OECD-LEGAL-0472%20)

This long-term, more sustainable approach has also a prudential supervision and public interest angle, as cooperative banks tend to be better capitalised, show less earnings volatility and higher resilience in economic downturns, thus preserving financial stability and avoiding the use of taxpayers' resources.[2]



Beyond these sustainable characteristics, many cooperative banks have evolved to create network organisations and intra-group protection schemes, further enhancing their resilience.

For these reasons, the EACB takes the view that the cooperative model should be considered as a positive factor when assessing governance in ESG ratings. While the methods of assessment are left to the discretion of ESG rating agencies, the EU legislative framework should protect the diversity of banking models and allow for the cooperative benefits to recognised as such.

More generally, EU legislation should help to maintain diversity in the financial sector as a means to preserve stability. Cooperative banks in particular have demonstrated their high resilience and systemic benefits[3], while supporting local economies through the financing of the real economy and development of communities.

[2] See, for further reference, the following academic studies: Chiaramonte, L., Poli, F., & Oriani, M. E. (2015). Are Cooperative Banks a Lever for Promoting Bank Stability? Evidence from the Recent Financial Crisis in OECD Countries. *European Financial Management*, *21*(3), 491–523. https://doi.org/10.1111/j.1468-036X.2013.12026.x ; Coccorese, P., & Shaffer, S. (2018). Cooperative Banks and Local Economic Growth. *SSRN Electronic Journal*, *May*. https://doi.org/10.2139/ssrn.3125909; San-Jose, L., Retolaza, J. L., & Lamarque, E. (2018). The social efficiency for sustainability: European cooperative banking analysis. *Sustainability (Switzerland)*, *10*(9). https://doi.org/10.3390/su10093271

[3] See for example Resilience in a Downturn: the power of financial cooperatives, International Labour Organization, 2013

ESG rating agencies should have a deep knowledge of the cooperative legal structure and business model, as a democratic and long-term oriented governance system. The EACB suggests ESG rating providers should be required to include the distinct cooperative governance structure under the Governance section of their assessment, as a governance model that tends to be clear of conflicts of interest, is inherently long-term oriented, and proves more stable from a financial perspective.

We thus suggest that the regulatory framework should reflect this need, and call for ESMA to account for the cooperative specificity when developing its draft regulatory technical standards under Article 21 and 22 on disclosure requirements for methodologies, models, and key rating assumptions used in ESG rating activities.

For further information or questions on this paper, please contact:

- Mr Volker Heegemann, Head of Department (Volker.Heegemann@eacb.coop)
- Ms Marieke van Berkel (Marieke.vanBerkel@eacb.coop)