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MAS Consults on Code of Conduct for ESG Rating and Data Product Providers

Introduction

Financial market participants have increasingly used Environmental, Social, and Governance ("ESG") ratings and ESG data products for investment and capital allocation. In its Final Report on "Environmental, Social and Governance (ESG) Ratings and Data Products Providers", the International Organisation of Securities Commissions ("IOSCO") identified key areas of concern and provided recommendations for good practices around governance, management of conflicts of interest ("COI") and transparency for ESG rating and data product providers. To promote the adoption and implementation of the good practices, IOSCO issued a "Call for Action" paper. Regulators worldwide are at various stages of developing regulatory approaches to regulate this nascent and rapidly changing industry.

The Monetary Authority of Singapore ("MAS") proposes to take a phased and proportionate regulatory approach, starting with a voluntary industry code of conduct ("CoC") it has co-created with industry players for ESG rating and data product providers, collectively referred to in this Update as "providers". The CoC sets a baseline industry standard of transparency in methodologies and data sources, governance, and management of COI. The CoC aims to increase the standards in the ESG rating and data product industry (with an emphasis on transparency and disclosure), and help users better assess these products against their needs.

On 28 June 2023, MAS issued a public Consultation Paper on "[Proposed Code of Conduct for ESG Rating and Data Product Providers](#)" to seek views on the draft CoC and the proposed plan for a future regulatory regime to bring ESG rating providers under MAS' regulatory ambit. The consultation closes on **22 August 2023**.

This Update outlines the key proposals in the Consultation Paper.

Scope of CoC

Broad definitions of "ESG Rating" and "ESG Data Product"

Similar to how these terms are defined under the IOSCO Report and the established codes of conduct for other jurisdictions, MAS proposes to define "ESG ratings" and "ESG data products" broadly. It is proposed for the CoC to cover products where:



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- the ESG rating entails an opinion on ESG profile or characteristics of the rated entity; or
- the ESG data provided to market participants entails estimations, calculations or analysis by the provider.

Excluded products

MAS proposes carve-outs for specific types of products where best practices in the CoC do not generally apply or need not be applied. These include the provision of products which are already subject to regulations in Singapore, for instance, credit ratings regulated under the Securities and Futures Act 2001 (“SFA”), and research analyses or research reports concerning any investment product regulated under the Financial Advisers Act 2001.

Additionally, MAS seeks feedback on whether external reviews such as Second Party Opinions (“SPOs”) should be covered under the definition of “ESG data product” under the CoC. Basically, SPOs are used to give an assurance or view to investors, and are generally different from ESG ratings and pure ESG data products. However, the best practices on governance and COI management in the CoC could be applied to such products. For instance, in Japan, such products are scoped in as “ESG Evaluation” and covered under Japan’s voluntary industry code of conduct.

Please refer to the full text of the definitions set out in the draft CoC at [Annex I](#).

Providers covered by CoC

MAS proposes that the CoC should cover providers who have a nexus to activities and institutions in the securities and derivatives industry in Singapore:

- the provider is based in Singapore and it provides ESG ratings and/or data products that relate to activities and institutions in the securities and derivatives industry, whether in Singapore and/or to overseas markets; or
- the provider is based overseas but it provides the ESG ratings and/or data products that relate to activities and institutions in the securities and derivatives industry in Singapore.

Excluded providers

MAS proposes carve-outs for specific ESG product providers who are not the intended participants of the CoC, for instance, an academic institution that solely provides ESG data for academic (and not commercial) purposes.

Please refer to the full text of the definitions set out in the draft CoC at [Annex I](#).

Key Principles and Best Practices

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The CoC sets out seven Principles, and each Principle is elaborated with a set of best practices. These Principles are focused on several key aspects, namely:

- Proper governance of providers;
- Implementation of proper policies and procedures to ensure transparency of methodology and data sources;
- Proper management and disclosures of COI; and
- Implementation of robust systems and controls.

The CoC is modelled closely after the IOSCO recommendations of good practices in the IOSCO's "Call for Action" paper with additional Singapore-specific requirements. Among other things, MAS has drawn references from the relevant provisions in the MAS Code of Conduct for Credit Rating Agencies and provides elaborations on specific best practices for the ESG rating provider in respect of their ESG ratings under the issuer-paid model. These specific best practices are marked out in the draft CoC.

Disclosure of forward-looking elements

The Consultation Paper emphasised that the key thrust of the CoC is to require the disclosure of forward-looking elements in ESG ratings and data products. It is important that providers adequately disclose whether they consider forward-looking elements, such as transition risks and opportunities, in their products. This will enhance market transparency (and particularly, address greenwashing) and allow users to better consider transition risks and opportunities when making decisions on capital allocation.

MAS proposes to enhance the IOSCO good practices on transparency, by further explicitly setting out in the CoC what product providers should adequately disclose, including:

- the measurement objectives of the ESG rating or data product, such as measuring the impact on the external environment and society, of the target entity covered by the ESG rating or data product ("**covered entity**"), and/or measuring risk exposure and resilience of the covered entity to physical and transition ESG risks; and
- the Key Performance Indicators used by the product provider to assess the covered entity against each criterion, such as the thresholds used to measure the ESG impacts and/or ESG risks, and related mitigation and adaptation measures, including the use of forward-looking strategic plans and targets of the covered entity in the provider's assessment.

For details of the Principles and best practices, please refer to the draft CoC at [Annex I](#).

Voluntary Adoption on a "Comply or Explain" Basis

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In line with the phased and proportionate regulatory approach MAS is adopting, the CoC will be implemented on a voluntary "comply or explain" basis. Providers would be required to either comply with the best practices set out in the CoC or explain why they could not comply with specific best practices.

Self-Attestation Checklist

To enable product users to easily identify compliant providers and facilitate interoperability for ESG rating and data product providers' global operations, MAS proposes that the providers also comply with a Self-Attestation Checklist ("**Checklist**") set out at [Annex II](#).

The Checklist clearly identifies (i) the respective best practices in the CoC that are aligned to IOSCO's recommended good practices; and (ii) the additional best practices that are tailored to Singapore. Providers can use the Checklist as a guidance of the progress of their adoption of the CoC's best practices. Additionally, this will facilitate interoperability with codes of conduct in other jurisdictions as providers can map their policies and procedures against IOSCO's recommended good practice and use it for cross-jurisdictional comparison of standards for their operations in other relevant jurisdictions. MAS encourages providers to start using this Checklist to identify best practices the providers are currently adopting, prior to the roll out of the CoC.

MAS also proposes for providers to publish their Checklists. Publication of their Checklists will enable industry players to easily use the Checklists to assess and select the appropriate providers to engage.

For better credibility, MAS proposes that providers undergo third-party assurance or audit on their self-attestations, on a voluntary basis. Verification by an independent party allows the providers to better demonstrate their compliance with the CoC, as well as provides users with better assurance that providers meet the minimum standards set out in the CoC.

Future Plans for Formalised Regulatory Regime of ESG Rating Providers

ESG rating providers need to exercise professional judgement in their issuance of an ESG rating and this involves their opinions which are subjective. These opinions may be relied upon by financial market participants in their investment decisions. As compared to ESG data products, ESG ratings are more challenging to interpret as they are subject to each providers' proprietary rating metrics, data inputs and assessments.

For the long-term regulation of ESG rating providers, MAS proposes to apply the Capital Markets Services ("**CMS**") licensing regime under the SFA to ESG rating providers. The proposed regulatory regime for the provision of ESG rating services will likely be similar to the regulatory regime for the provision of credit rating services. As CMS licensees, the ESG rating providers would have to comply

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with the corresponding Regulations, Guidelines and Notices under the SFA, including a code of conduct which could be modelled on the CoC. This will give MAS supervisory and enforcement powers over ESG rating service providers, and ensure that ESG rating providers operating in Singapore (i) are fit and proper; (ii) have in place proper governance structure, expertise and resources to produce quality and credible ESG ratings; and (iii) meet the requirement on transparency in methodologies and data sources.

Regarding the definition of "providing ESG rating services", MAS proposes that at minimum, the scope should cover companies based in Singapore providing ESG rating services. This approach is similar to the regulation of credit rating service providers. MAS is aware of the challenges to extend the regulatory ambit beyond Singapore but also notes the potential risk of harm to users in Singapore where ESG ratings are offered by overseas-based providers. As such, MAS seeks views on whether overseas-based ESG rating providers who offer ESG ratings to users in Singapore should be subject to the proposed regulatory regime for ESG rating providers, and the scope of activities of such providers to be subject to regulatory requirements.

For now, MAS will monitor the implementation of the CoC and global developments, and will conduct a more detailed public consultation to formalise a local regulatory framework when there is greater regulatory convergence globally.

Our Comments

The proposed CoC and particularly, the proposed formal regulatory regime for ESG data providers in future is a significant development in this industry. MAS is proposing that ESG rating and data product providers adopt and comply with the CoC and publish their assessment of compliance or otherwise explain why they could not comply with best practices. MAS also encourages market participants who use the ESG ratings and/or ESG data products to engage providers who adopt the CoC. In light of this, ESG rating and data product providers, as well as other market participants, should carefully review the proposals in the Consultation Paper and the draft CoC, including the scope of coverage and consider the potential impact on their businesses and operations. As public consultation is still ongoing, the providers and other market participants should take this opportunity to share their views and input on the best practices which are set out in the draft COC as these are likely to become the best practices that they would have to comply with in future or explain any deviations.

Further Information

If you have any queries on this development, please feel free to contact our team below.

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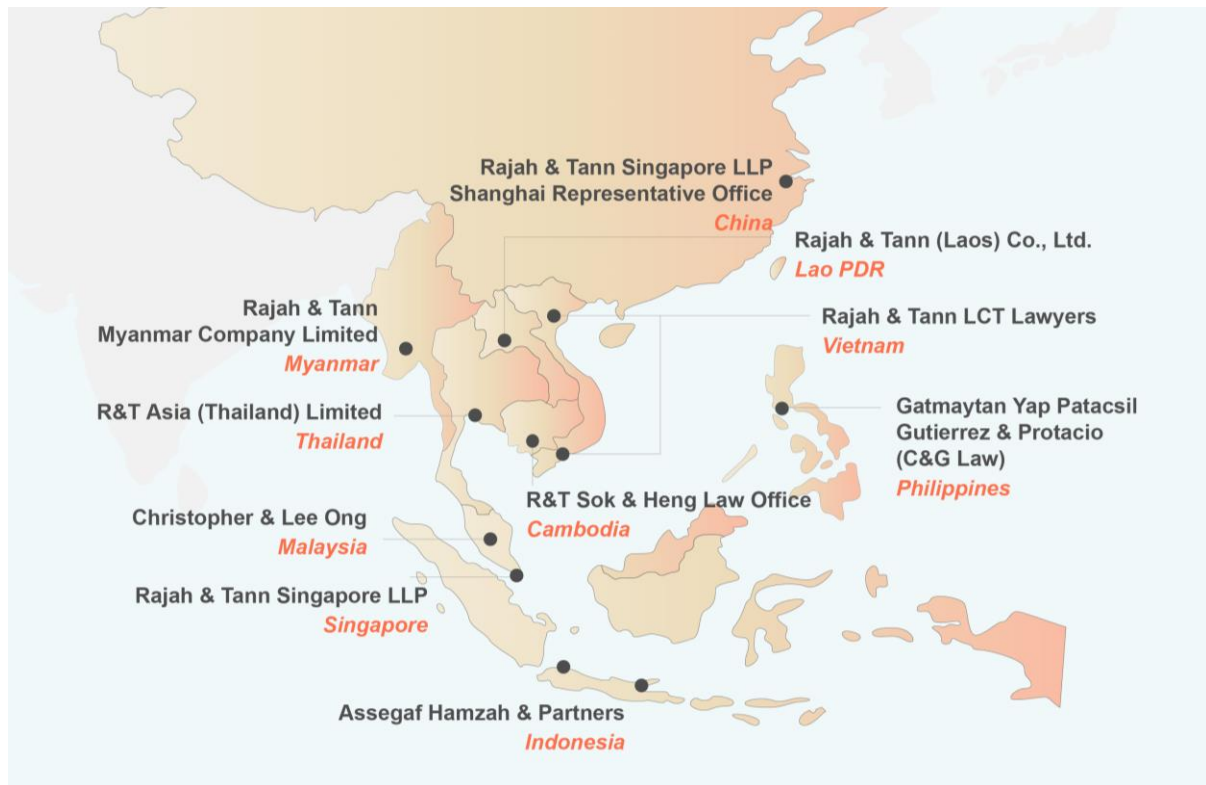
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