HM Treasury
1 Horse Guards Rd
London
SW1A 2HQ

By email: ESGRatingsConsultation@HMTreasury.gov.uk

14 January 2025

Dear HMT team,

BVCA feedback on the future regulatory regime for ESG ratings providers

HM Treasury's consultation response (November 2024) and draft statutory instrument (SI) - The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No. 2) Order 2024

The British Private Equity and Venture Capital Association (**BVCA**) is the industry body and public policy advocate for the private equity (**PE**) and venture capital (**VC**) (**private capital**) industry in the UK. We represent the vast majority of all UK-based private capital firms, as well as their professional advisers and a large base of UK and global investors. In 2023, a total of £59.6bn was raised by UK-managed funds to be invested globally, with £20.1bn having been invested by private capital into UK businesses in sectors across the UK economy. There are over 12,000 UK companies backed by private capital which currently employ over 2.2 million people in the UK. Approximately 58% of the businesses backed are outside of London and 90% of the businesses receiving investment are small and medium-sized enterprises (**SMEs**).

We fully support the Government's aim of attracting global business that will drive the green transition and boost economic growth in the UK. The UK's private capital industry is a key partner for helping to deliver these objectives. Firstly, the industry draws global investment through the UK and into UK companies. Secondly, ESG focussed firms use the industry's active ownership model to: (a) supercharge the growth of new businesses offering innovative solutions to sustainability challenges; and (b) improve the long-term ESG performance of a wide range of UK companies, UK SMEs in particular (as this increases a company's likely sale price and investors' returns). It is therefore important for UK growth and the green transition that UK regulation in general supports private capital activity in the UK.

We are grateful for the opportunity to provide feedback on the Government's proposals to improve transparency around ESG ratings providers. We have set out our comments below and are happy to discuss or clarify any of these points further if that would be helpful.

Summary

We are broadly supportive of the Government's proposals to develop a robust and transparent ESG ratings sector, which we think will support transparency and comparability for listed companies and investment products available to retail investors in particular. ESG ratings services are typically not used by private capital firms to make investment decisions, because providers are unlikely to have better visibility on a private company's ESG performance than the company's private capital owners.

British Private Equity & Venture Capital Association
3rd Floor, 48 Chancery Lane, London WC2A 1JF
+44 (0)20 7492 0400 | bvca@bvca.co.uk | www.bvca.co.uk

We agree with the Government's proposal that asset managers and others who produce and make available ESG ratings as part of another regulated activity should not be required to obtain additional UK FCA permissions, and that it would be disproportionate to require such dual authorisation.

However, we have concerns that, without the limited amendments we describe below, the UK regime could introduce disproportionate new requirements for private capital firms, undermine interoperability with overseas frameworks and discourage firms from offering private capital funds from and into the UK. This would have a detrimental impact on the competitiveness of the UK as a location for private capital investment. This is particularly the case for overseas asset managers who run global funds marketed to UK professional investors from other jurisdictions: the proposed SI needs to make clear that these managers will be out of scope of the new framework in relation to their ordinary activities in the same way that UK regulated firms will be. It is also the case for UK asset managers seeking to establish funds in the UK and market these nationally and/or globally, targeting professional investors.

Whilst it is unlikely that most UK private capital firms will be required to seek authorisation for the new regulated activity of providing an ESG rating (as any private capital firms in scope of "providing ESG ratings" would carry out that activity in the course of existing regulated activities), we expect the FCA will use the statutory instrument as the basis for making rules covering the provision of an ESG rating. So it is important that the definition of this activity (together with the exclusions) take ordinary activities of asset managers out of scope.

Unless these issues are addressed, we are concerned that some of these managers may cease offering products into the UK which would continue to be offered to professional investors in other jurisdictions. This is because global private capital managers typically offer one or two vehicles in any fund structure globally, rather than (as is the case for retail funds), developing local funds which are offered locally. So whilst a retail fund manager typically establishes local funds tailored to comply with local legal requirements, alternative asset managers establish global funds and rely on jurisdictions applying lighter touch regulation to such funds because they are limited to professional investors. If the UK were to require non-UK fund managers to become regulated in the UK in order to comply with the ESG ratings regime, many fund managers are likely to conclude it is preferable not to offer their funds in the UK rather than establish a newly licenced entity (for potentially a small proportion of their global investor base).

We believe that these concerns should be addressed in part by amendments to the draft statutory instrument and in part by clear FCA guidance around the scope of the rules relating to the regime. However, we think it would be helpful for HM Treasury to give a clear steer at this stage about its expectations of the area of coverage of the FCA rules in order to allay concerns about the scope of the requirements.

Our concerns, in particular, are:

(a) It is unclear whether the proposals would require managers to treat ESG labels or product classifications used as part of their fund marketing as "ESG ratings". This might include SDR labels, funds disclosing under the SFDR regime pursuant to article 8/9 classifications or the proposed SFDR 2.0 categorisations. It should be clarified that these will not classify as ESG ratings under the UK proposals. These classifications should be specifically excluded from the definition of "ESG rating" in the statutory instrument since the regulatory requirements applicable to these offerings should prevail. Any disclosures made to comply with UK or non-UK rules (e.g. SFDR mandatory periodic disclosures) should be specifically excluded. This would bring UK ESG ratings regulation into line with the proposed EU Ratings Regulation, which specifically exempts from the application of the rules, the use of classifications and/or ratings in a number of cases, including (i) ESG ratings issued by a regulated financial undertaking that are incorporated in a product or a service where that product or service is already regulated (under EU law (e.g. SFDR, AIFMD, MIFID, CRD IV etc.)) and are disclosed to third parties, and (ii) mandatory disclosure pursuant to art. 6, 8, 9 , 10, 11 and 13 SFDR and articles 5,6, and 8 of the EU taxonomy.

(b) Non-UK managers of funds marketed to professional investors in the UK under the national private placement regime should be afforded the same treatment as OFR fund managers and excluded from authorisation in the definition of "*market access arrangement*". There is no mention of this in the consultation paper.

(c) Overseas service providers relying on the overseas persons exclusion to provide regulated activities to recipients in the UK should be able to rely on that exclusion where ESG ratings are provided as part of that service. For instance, if a non-UK person provides investment advice in reliance on the overseas persons exclusion and provides ESG ratings as part of that service, the UK should preserve the existing overseas persons approach and not regulate the ESG ratings part of the service.

We set out our detailed reasons below.

Definition of "ESG rating"

1. *Dual regulation*

The draft SI is drafted broadly. On the face of it, the definition of "ESG rating" potentially captures products and services that are already regulated under existing UK and/or EEA regulatory regimes which produce a label or product classification relating to ESG, for disclosure and other purposes. For example, The UK Sustainability Disclosure Requirements and investment labels regime (**SDR**), and the EEA Sustainable Finance Disclosure Regulation (**SFDR**).

Such labelling or classification criteria already attach a significant degree of product governance and disclosure requirements for investor protection, and therefore are specifically excluded from scope of European regulation on ESG ratings providers (Regulation (EU) 2024/3005) (**EEA Ratings Regulation**), including any related mandatory disclosures (e.g. SFDR pre-contractual and periodic disclosures to investors). They are not marketing communication tools designed to influence investment decisions or the allocation of capital but mandatory disclosure documents subject to detailed regulatory requirements for investor protection purposes.

To avoid dual regulation, such products and related mandatory disclosures should be excluded from scope of UK regulation of ESG ratings providers, specifically from the definition of "ESG rating", on the same basis.

Exclusions

"Regulated products and services"

1. **Article 63V. (1)(c) – "an activity that is within the scope of a [*market access arrangement*]"**

We appreciate the Government continues to consider the exclusion for regulated products and services of overseas firms who incorporate ESG ratings and benefit from "market access arrangements", and a draft definition of "market access arrangement" is not yet published.

We are in support of HM Treasury's consultation response on including within scope of the exclusion EEA regulated funds registered for marketing to retail investors under The Overseas Funds Regime (**OFR**) in the UK. Such funds are already subject to consumer protection measures equivalent to UK funds.

Unregulated alternative investment funds (**AIFs**) are typically used by private capital and registered for marketing to *professional* investors under the national private placement regime in the UK (e.g. a Luxembourg AIF managed and marketed by a Luxembourg alternative investment fund manager (**AIFM**)). They are also subject to existing investor protection requirements pursuant to the EEA Alternative Investment Fund Managers Directive (as amended and implemented in the UK) and should be excluded on the same basis as OFR funds, in line with HMT's policy to avoid dual regulation.

Overseas persons exclusion

In order to preserve the existing overseas persons exclusion for investment advice, it should be clarified that ESG ratings provided as part of investment advice may also benefit from the exclusion in article 72 of the Regulated Activities Order.

If you have any questions or points it would be helpful to discuss further, please contact Tom Taylor ttaylor@bvca.co.uk or Harriet Assem hassem@bvca.co.uk.

Yours faithfully,

Tim Lewis

Chair, BVCA Regulatory Committee

British Private Equity & Venture Capital Association
3rd Floor, 48 Chancery Lane, London WC2A 1JF
+44 (0)20 7492 0400 | bvca@bvca.co.uk | www.bvca.co.uk