

# **Environmental, Social and Governance (ESG) Ratings and Data Products Providers**

## **Consultation Report**



**OICU-IOSCO**

**The Board  
OF THE  
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS**

**CR02/21**

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This paper is for public consultation purposes only. It has not been approved for any other purpose by the IOSCO Board or any of its members.

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## Foreword

The Board of the International Organization of Securities Commissions (IOSCO) has published this Consultation Report with the aim of assisting IOSCO members in understanding the implications of the activities of ESG ratings and data products providers (the term includes ESG ratings providers, ESG data products providers as well as providers who offer both ESG ratings and data products). The report proposes recommendations to mitigate risks associated with ESG ratings and data products and to address some of the existing challenges faced by ESG ratings and data products providers, users of ESG ratings and data products, and the companies that are the subject of these ESG ratings or data products.

## How to Submit Comments

Comments may be submitted by one of the three following methods **on or before 6 September 2021**. To help us process and review your comments more efficiently, please use only one method.

**Important:** All comments will be made available publicly unless anonymity is specifically requested. Comments will be converted to PDF format and posted on the IOSCO website. Personal identifying information will not be edited from submissions.

### 1. Email

- Send comments to [consultation-02-2021@iosco.org](mailto:consultation-02-2021@iosco.org)
- The subject line of your message must indicate ‘*Public Comment on ESG Ratings and Data Products Providers*’
- If you attach a document, indicate the software used (e.g., WordPerfect, Microsoft WORD, ASCII text, etc) to create the attachment.
- Do not submit attachments as HTML, PDF, GIF, TIFF, PIF, ZIP or EXE files.

### 1. Facsimile Transmission

Send by facsimile transmission using the following fax number: + 34 (91) 555 93 68.

### 2. Paper

Send 3 copies of your paper comment letter to:

Kris Nathanail-Brighton  
International Organization of Securities Commissions (IOSCO)  
Calle Oquendo 12  
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Spain

Your comment letter should indicate prominently that it is a ‘*Public Comment on ESG Ratings and Data Products Providers*’.

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## Executive Summary

The use of environmental, social and governance (ESG) ratings and data products has grown considerably in response to investors' mounting interest in investing in companies that take account of sustainability in the way they are run. As a result, the role and influence of ESG ratings and data products providers<sup>1</sup> in financial markets more generally, and in the sustainable finance ecosystem more specifically, have grown significantly. This has led some securities markets regulators to take a closer interest in the activities and business models of these providers.

Given that this part of the market does not currently fall within the typical remit of securities regulators, IOSCO has sought to strengthen its knowledge by undertaking a fact-finding exercise with ESG ratings and data products providers, users of ESG ratings and data products, and the companies that are the subject of these ESG ratings or data products.

The fact-finding exercise revealed that:

- there is little clarity and alignment on definitions, including on what ratings or data products intend to measure;
- there is a lack of transparency about the methodologies underpinning these ratings or data products;
- while there is wide divergence within the ESG ratings and data products industry, there is an uneven coverage of products offered, with certain industries or geographical areas benefitting from more coverage than others, thereby leading to gaps for investors seeking to follow certain investment strategies;
- there may be concerns about the management of conflicts of interest where the ESG ratings and data products provider or an entity closely associated with the provider performs consulting services for companies that are the subject of these ESG ratings or data products; and
- better communication with companies that are the subject of ESG ratings or data products was identified as an area meriting further attention given the importance of ensuring the ESG ratings or other data products are based on sound information.

This Consultation Report (Report) explores these developments and challenges and seeks to better understand the implications of the increasingly important role of ESG ratings and data products for financial markets. It does so by identifying potential areas for improvement within this part of the sustainable finance ecosystem, which in turn form the basis for a series of proposed recommendations for securities markets regulators as well as ESG ratings and data products providers, users of ESG ratings and data products and the companies that are the subject of these ratings or data products. ESG ratings and data products providers are treated the same in this Report for efficiency. However, not everything stated to apply to ESG rating providers may apply to ESG data products providers, and vice versa, and commenters are encouraged to provide feedback on specific areas where distinctions may be appropriate.

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<sup>1</sup> The term ESG ratings and data products providers, as used in this report, covers providers who offer ESG ratings and/or ESG data products. Where there is a need to single out ESG data products providers who do not provide ESG ratings, the term ESG data products providers is used.

The Report is structured around five chapters. **Chapter 1** provides an overview of the market for ESG ratings and data products; **Chapter 2** discusses the current practices of ESG ratings and data products providers. **Chapter 3** discusses observations in relation to users of ESG ratings and ESG data products while **Chapter 4** elaborates on the interactions between companies that are the subject of ESG ratings or data products and ESG ratings and data products providers. Finally, **Chapter 5** discusses areas for improvement highlighted in the fact-finding exercise and sets out some proposed recommendations for securities markets regulators, ESG ratings and data products providers, users of these products and services, and companies subject to these providers' review.

The proposed recommendations start with a proposal that regulators may wish to consider focusing greater attention on the use of ESG rating and data products and the activities of ESG rating and data products providers in their jurisdictions. This is followed by a set of proposed recommendations addressed to ESG rating and data products providers, proposing that they may wish to consider a number of factors related to issuing high quality ratings and data products, including publicly disclosed data sources, defined methodologies, management of conflicts of interest, high levels of transparency, and handling confidential information. The proposed recommendations also suggest that users of ESG ratings and data products may wish to consider conducting due diligence on the ESG rating and data products that they use within their internal processes. And the proposed recommendations close with suggestions that ESG rating and data products providers, and entities subject to assessment by ESG rating and data products providers may wish to consider to improve information gathering processes, disclosures and communication between providers and entities subject to assessment.

# Introduction

## Background

IOSCO has established a Board-level Sustainable Finance Task Force (STF), with the aim of: (i) improving sustainability-related disclosures made by issuers and asset managers; (ii) collaborating with other international organisations to avoid duplicative efforts and enhance coordination of relevant regulatory and supervisory approaches; and (iii) preparing case studies and analyses of transparency, investor protection and other relevant issues within sustainable finance.

To achieve these objectives, the STF is carrying out work in three areas:

- Workstream 1 (WS1) - sustainability-related disclosures for issuers;
- Workstream 2 (WS2) - sustainability-related practices, policies, procedures and disclosures for asset managers; and
- Workstream 3 (WS3) - ESG rating and data products providers.

This Report focuses on questions related to ESG ratings and data products, with the aim of understanding the implications of the activities of ESG ratings and data products providers on sustainable investing. Indeed, as investors become more sensitive to the potential financial risks posed by climate change and the potential impact of other ESG considerations, such considerations are becoming increasingly significant in investment decision making. Investor demand, as well as regulatory developments, are encouraging the development of new ESG ratings and data products.<sup>2</sup>

These evolutions have led to a surge in demand, on a global basis, for ESG ratings and data products by financial market participants, as they seek to assess the sustainability track record of companies in which they invest. In that context, ESG ratings and data products providers, for example, offer investors a way to screen companies for ESG performance.

This rise in demand has led to the proliferation of participants in the ESG ratings and data products industry, including established market participants such as credit rating agencies (directly or through their affiliates) or market infrastructure providers such as exchanges. This trend, which is accompanied by a growing concentration in the industry, is expected to continue, with some predicting the market for ESG data products could reach USD 1 billion by 2021, with an expected annual growth of 20 percent, while ESG indexes could grow by 35 percent.<sup>3</sup>

The increasing reliance on ESG ratings and data products from private providers may have been compounded, in part, by the fact that ESG reporting by companies is a relatively new

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<sup>2</sup> For example, asset managers in the European Union will be required to integrate ESG considerations into their fiduciary duties from January 2022: more information available at Sustainability-related disclosure in the financial services sector | European Commission (europa.eu)

<sup>3</sup> Anne-Laure Foubert, 2020-03-09, ESG Data Market: No Stopping Its Rise Now, <http://www.opimas.com/research/547/detail/>

development in contrast to financial reporting.<sup>4</sup> This currently makes it difficult for investors to assess ESG performance and risk management based on standardised criteria; hence their inclination to use ESG ratings and data products from private providers. Transparency in ESG ratings and data methodologies is paramount, particularly as these methodologies vary significantly in terms of the ESG topics they cover, how these topics are weighted, and the metrics used to measure ESG performance.

Given that the activities of ESG ratings and data products providers are not generally subject to regulatory oversight at the moment, increasing reliance on these services raises concerns about the potential risks they pose to investor protection, the transparency and efficiency of markets, risk pricing, and capital allocation. In addition, the lack of standards in this area may present the risk of greenwashing or misallocation of assets and could lead to a lack of trust in ESG ratings or in the data products' robustness or relevance.

To better understand this part of the sustainable finance ecosystem, IOSCO conducted a fact-finding exercise, consisting of (i) a series of roundtables with market participants organised in December 2020 and (ii) a survey questionnaire for market participants in January 2021. The questionnaire was sent to more than 65 participants including ESG ratings and data products providers, users of such products, and companies that are assessed by these providers. Some of the feedback received by specific participants has been highlighted within the Report, as these statements provided salient examples of the broader topics discussed within sections of the Report. Finally, IOSCO members contributing to this project have conducted desktop research in collaboration with the IOSCO Secretariat.

While the fact-finding exercise underpins the observations in this Report and the ensuing proposed recommendations, the information provided may not be comprehensive. Therefore, IOSCO welcomes more input from a broader set of stakeholders through this public consultation. For example, ESG rating and data products providers are treated the same in this Report for efficiency. However, not everything stated to apply to ESG rating providers may apply to ESG data products providers, and vice versa, and commenters are encouraged to provide feedback on specific areas where distinctions may be appropriate. The broader input will also help to further develop an overview of the providers of ESG ratings and data products currently active in different geographic regions globally. To support this initiative, IOSCO has included a template in Annex 2 of this Report, for respondents to fill in.

### **Synergies with the other STF workstreams**

IOSCO, through WS1, has engaged with the International Financial Reporting Standards (IFRS) Foundation as the IFRS Foundation has worked towards the establishment of an International Sustainability Standards Board (ISSB).

IOSCO considers that the IFRS Foundation could potentially deliver a global baseline for investor-oriented sustainability-related disclosure standards focussed on enterprise value creation, which jurisdictions could consider incorporating or building upon as part of their mandatory reporting requirements as appropriate and consistent with their domestic legal

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<sup>4</sup> IOSCO is working in close collaboration with the IFRS Foundation in establishing the International Sustainability Standards Board aimed at providing a global baseline of sustainability reporting standards to meet investor needs and set the basis for a globally comprehensive corporate reporting system.



frameworks. This could promote international consistency and comparability in sustainability-related information and also form the basis for the development of an audit and assurance framework.

IOSCO recognises that individual jurisdictions have different domestic arrangements for adopting, applying or otherwise availing themselves of international standards. It will be important for individual jurisdictions to consider how the common global baseline of standards can be adopted, applied or utilised within the context of these arrangements and wider legal and regulatory frameworks in a way that promotes consistent and comparable sustainability disclosures across jurisdictions.

IOSCO has strongly encouraged the ISSB to leverage existing sustainability-related reporting principles, frameworks and guidance, including the Task Force on Climate-related Financial Disclosures Framework (TCFD Framework), as it develops investor-oriented standards focused on enterprise value, beginning with climate change.

IOSCO has encouraged a ‘building blocks’ approach to establishing a globally comprehensive corporate reporting system. This could provide a consistent and comparable global baseline of sustainability-related information that is investor-focused and material to enterprise value creation, while also providing flexibility for interoperability with reporting requirements that capture wider sustainability impacts. These important elements of an ISSB under the IFRS Foundation are covered in the WS1 report.<sup>5</sup>

These efforts by WS1 are intended to drive much-needed international consistency and comparability in sustainability-related information and form the basis for the development of an audit and assurance framework to enhance reliability of disclosures. In turn, this information could become an essential part of any methodology underpinning the development of ESG ratings or data products. In that way, these efforts could have the additional benefit of increasing trust by users such as asset managers in the ratings and data products developed by ESG ratings and data products providers.

Nevertheless, given the current lack of consistent information at the level of corporate disclosures, ESG-focussed investors may need to place greater reliance on the ESG ratings and data products developed by ESG ratings and data products providers. The WS2, which focusses on the activities of asset managers as an important agency-model business which channels investor capital into sustainable finance, notes the importance of ESG ratings and data products in the decisions made by these asset managers.<sup>6</sup>

Some institutional asset owners have indicated they use ESG ratings as a basis for reviewing the activities of their asset managers and to assess the implementation of investment mandates or identify where further engagement is necessary.

Here, and elsewhere in the Report where relevant, “snapshots” of stakeholder feedback have been provided, where the statements made were salient examples of the broader topics

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<sup>5</sup> The STF Workstream 1 report can be accessed at the following link:  
<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD678.pdf>

<sup>6</sup> The STF Workstream 2 report can be accessed at the following link:  
<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD679.pdf>

discussed within sections of the Report. The “snapshot” boxes include selected statements of particular fact-finding participants and are not representative or summary statements of all stakeholder feedback. They are also not intended to reflect IOSCO’s views.

<b>Table 1: Comments Provided by Stakeholders During IOSCO Fact-Finding Exercise</b>
<b>ESG ratings as an indicator for further analysis / follow up for an entity</b>
<i>We use the profile of an issuer or entity primarily for our engagement with external asset managers. We raise inquiries as to how our asset managers view ESG risks of certain companies, their interaction with company management as well as the potential ESG opportunities identified.</i>
<b>ESG data can be used as a tool for specific purposes</b>
<p><i>Asset managers use ESG data about investee companies and investments in many different ways, including:</i></p> <ul style="list-style-type: none"> <li>• <i>For investing – for example, as a research input in the investment process, a risk management tool, a component in an ESG-related investment strategy, or to inform stewardship and engagement with investee companies;</i></li> <li>• <i>For client reporting; and</i></li> <li>• <i>For regulatory purposes – for example, to comply with ESG-related disclosure requirements (e.g., the EU Sustainable Finance Disclosure Regulation).</i></li> </ul>

As such, the activities of ESG ratings and data products providers feature prominently across all three IOSCO STF workstreams due to the central role ESG ratings and data products play in the broader ecosystem of sustainable finance.

# Chapter 1: Product and Market Overview

## Introduction

This chapter provides an overview of the market for ESG ratings and data products. It outlines the types of firms that act as ESG ratings and data products providers before providing an overview of some of the current products available to financial market participants.

### *Scoping of industry*

In a rapidly moving and diversified market, and in the absence of global standards for this industry, developing an overview of the market for ESG ratings and data products providers is challenging. While steps have been carried out to map existing providers and products in some jurisdictions, the mapping is only partial.<sup>7</sup> Nonetheless, KPMG estimates that there are 160 ESG ratings and data products providers worldwide.<sup>8</sup> These include both for-profit and non-profit companies that offer large or specialised ESG-related products. At the regional level, a report recently prepared for the European Commission identified 30 to 40 other smaller providers of ESG ratings, data and research products and services domiciled in the European Union, although such data is harder to find in other jurisdictions.<sup>9</sup> From a revenue perspective, according to a recent study by UBS, global revenues generated by ESG data and services could more than double by 2025.<sup>10</sup>

## Products and market overview

The market for ESG ratings and data products is currently in a phase of rapid growth and is expected to continue growing at pace over the coming years. The reasons behind this growth are two-fold. First, there is increasing legislative and regulatory focus on financial market participants' consideration of the ESG characteristics of potential investments, with some jurisdictions imposing or considering imposing new regulatory obligations. Second, there is increasing demand from investors for products that will push society towards a greener economy and mitigate the risks stemming from climate change. These two drivers are only likely to increase in intensity over the coming years, leading to ESG ratings and data products taking on a more important role in the financial sector.

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<sup>7</sup> December 2020: AMF Report on Provision of Non-Financial data: Mapping of stakeholders, products and services available at <https://www.amf-france.org/en/news-publications/publications/reports-research-and-analysis/provision-non-financial-data-mapping-stakeholders-products-and-services>. January 2021 Study by European Commission on Sustainability-related ratings, data and research available at [Sustainability-related disclosure in the financial services sector | European Commission \(europa.eu\)](https://ec.europa.eu/economy_finance/sustainability-related-disclosure-in-the-financial-services-sector_en).

<sup>8</sup> KPMG, Sustainable Investing: Fast-Forwarding Its Evolution, February 2020 available at <https://assets.kpmg/content/dam/kpmg/xx/pdf/2020/02/sustainable-investing.pdf>.

<sup>9</sup> European Commission, *Study on Sustainability-Related Ratings, Data and Research*, Report prepared by Sustainability, January 2021 available at <https://op.europa.eu/en/publication-detail/-/publication/d7d85036-509c-11eb-b59f-01aa75ed71a1/language-en/format-PDF/source-183474104>.

<sup>10</sup> <https://www.ubs.com/global/en/investment-bank/in-focus/covid-19/2020/esg-data-and-services.html>

### *Providers and consolidation*

The global market for ESG ratings and data products is concentrated around a small number of providers with a global presence, alongside a larger number of providers with a more regional focus or offering more specialized services.

Following consolidation moves in recent years, some of these larger, more established market participants – notably credit rating agencies, exchanges, data and index providers – have begun to acquire smaller and more specialised ESG providers (see Table 2) and/or have invested significant resources to develop their own ESG expertise/capacities. However, where consolidations have occurred, only a few companies appear to have been fully integrated into the acquiring company, with the vast majority of acquired companies retaining their legal status by becoming a subsidiary of the acquiring entity.

<b>Year</b>	<b>Target</b>	<b>Acquirer</b>
2016	Trucost (UK)	S&P Global (US)
2017	Sustainalytics (Netherlands) – acquisition of a 40% stake	Morningstar (US)
	South Pole (Switzerland) (Investment Climate Data Division)	ISS (US)
2018	Solaron (India)	Sustainalytics (Netherlands)
	Oekom (Germany)	ISS (US) (acquired in 2020 by Deutsche Börse Group)
2019	Vigeo-Eiris (France)	Moody’s Corp (US)
	Beyond Ratings (France)	London Stock Exchange (UK)
	Four Twenty Seven (US)	Moody’s Corp (US)
	GES International (Sweden)	Sustainalytics (Netherlands)
	Carbon Delta (Switzerland)	MSCI (US)
	SynTao Green Finance (China) - minority stake	Moody’s Corp (US)
	Ethical Corp (US)	S&P Global (US)
	Robecosam AG-ESG Ratings Business (Switzerland)	S&P Global (US)
2020	Sustainalytics (Netherlands) – 100% stake	Morningstar (US)
	Ecovadis (France) - Non-controlling interest	CVC Growth Partners (US)
	TrueValueLab (US)	Factset (US)

*Source: Company releases*

Smaller companies operate in the ESG ratings and data products market alongside those large, international providers. These smaller actors generally tend to have a specific regional presence and/or specialisation in specific data sets (e.g., climate, controversies), coverage (e.g., small and medium enterprises, sovereign issuers) or services (e.g., certification, second party opinions

and consulting services). There are also a number of start-ups and fintech companies entering the market and offering new products, which usually focus on using and leveraging big data and artificial intelligence in their product offerings.

*A variety of ESG ratings and data products provided and growth of new offerings*

A wide variety of ESG ratings and data products have emerged in response to investor needs, reflecting the importance of the availability of these products for investment decision processes and other uses. ESG ratings and data product offerings are constantly evolving to respond to new topics of interest (e.g., share of green activities, contribution to the United Nations’ Sustainable Development Goals) and emerging areas of attention (e.g., environmental, diversity and inclusion, and biodiversity).

Some of these products are set out for illustrative purposes within Table 3 alongside a reminder of how these terms are to be understood within this Report.<sup>11</sup> It should however be noted that product names, objectives and methodological practices can vary significantly across ESG ratings and data products providers, even for comparable products.

<b>Table 3: Overview of ESG Rating and Data Products - Sample Provider 1</b>	
1	<b>Controversy Activity Screening:</b> Assessment of a company’s level of involvement in 17 controversial activities
2	<b>Controversial Weapons Screenings:</b> Assessment of a company’s involvement in 10 types of weapons
3	<b>Controversy Risk Assessments:</b> Aggregate view of a company’s exposure to and management of ESG and Climate related controversies
4	<b>Sustainable Goods and Services Assessments:</b> Assessment of a company’s level of involvement in 90+ sustainable goods and services. Covers a broad range of ESG and Sustainability factors including contribution to climate change mitigation and adaptation.
5	<b>Sustainable Development Goals (SDG) Assessments:</b> Measures a company’s level of contribution across the SDGs through their products & services and business behaviour
6	<b>UN Global Compact Assessment:</b> Normative framework assessment of a company’s capacity to manage ESG responsibilities outlined by the UN Global Compact
7	<b>Corporate ESG Assessments and Scores:</b> Scores a company’s capacity to manage ESG factors as defined by international standards. Scores include scores for 28 ESG drivers, an E, S, G and a composite ESG score, derived from public information
8	<b>Sovereign ESG Assessments and Scores:</b> Scores a Sovereign entity’s performance on 172 ESG risk and performance indicators
9	<b>Sustainability Ratings:</b> Analysis of a company’s multi-stakeholder impact taking into account performance under dual materiality considerations. The sustainability rating includes a company’s risk exposure to ESG factors, their management of ESG factors and their ESG impact (positive)
10	<b>ESG Benchmark Analysis:</b> Customised peer benchmarking for a company including ESG assessment ranking and best practice insights

<sup>11</sup> A more detailed overview is available in European Commission Report (2021), available at <https://op.europa.eu/en/publication-detail/-/publication/d7d85036-509c-11eb-b59f-01aa75ed71a1/language-en/format-PDF/source-183474104>

11	<b>Corporate Physical Climate Risk Scores:</b> Asset-level data on exposure to floods, heat stress, hurricanes and typhoons, sea level rise, water stress and wildfires
12	<b>Sovereign Physical Climate Risk Scores:</b> Aggregate physical climate risk scores for each jurisdiction based on the total and percentage of agriculture, population and GDP (purchasing power parity) exposed.
13	<b>Corporate Transition Risk Scores:</b> <ul style="list-style-type: none"> <li>• Brown share data to assess exposure to fossil fuels, including a company’s revenue, reserves, potential emission and power fossil fuels</li> <li>• Carbon footprint measuring a company’s carbon emissions</li> <li>• Temperature alignment assessing how a company’s emissions reduction targets align with different temperature pathways.</li> </ul>
14	<b>Energy Transition Score:</b> Measures a company’s preparedness for the transition to a low-carbon economy.
15	<b>Physical Risk Management:</b> Demonstrates how a company anticipates, prevents and manages physical risks.
16	<b>TCFD climate strategy:</b> Analyses how a company’s disclosures align with the TCFD’s recommendations.
17	<b>Sovereign Transition Risk:</b> Measures emission by jurisdiction covering its whole production-based emissions and carbon intensity (emission per unit of GDP).
18	<b>Daily Monitoring and Alerts:</b> Daily monitoring of ESG related events covering 38 ESG Criteria and 160+ underlying topics on ~8,000 companies.

Source IOSCO WS3 Questionnaire

The ESG ratings and data products offered by another provider are illustrated below:

<b>Table 4: Overview of ESG Ratings and Data Product Offerings: Sample Provider 2</b>	
1	<b>Carbon Risk Rating</b> Evaluates to what extent a company copes with future challenges related to climate change and seizes opportunities arising from a transition to a low-carbon economy using 100+ carbon performance indicators, most of which are industry-specific.
2	<b>Climate Solutions</b> Supports financial market participants in understanding, measuring, and acting on climate-related risks and their impact on investments across asset classes. ESG’s analysis is based on a proprietary database of company greenhouse gas (“GHG”) information.
3	<b>Controversial Weapons Screening</b> Helps investors make decisions regarding companies directly or indirectly involved in the development, production, maintenance or sale of controversial weapons including, but not limited to, biological and chemical weapons, nuclear weapons, anti-personnel mines, and cluster munitions.
4	<b>Energy &amp; Extractives Screening</b> Assesses companies’ involvement in the extraction of fossil fuels and the generation of power from fossil fuel, nuclear and renewable sources.
5	<b>E&amp;S Disclosure Quality Score</b> Measures and identifies companies’ environmental, social and governance disclosure practices with data-driven scoring and screening solutions.
6	<b>Global Sanctions Screening</b> Assesses companies with ties to jurisdictions of concern and/or jurisdictions under United Nations (UN) United States (US) or European Union (EU) sanctions.
7	<b>Norm-Based Research</b> Assesses companies’ adherence to international norms on human rights, labour standards, environmental protection and anti-corruption as set out in the UN Global Compact and the Organisation for Economic Cooperation and Development (OECD) Guidelines.
8	<b>Pooled Engagement</b> A dialogue and engagement service carried out with companies identified through its Norm-Based Research as facing credible allegations of corporate misconduct according to the four norm pillars noted in the UN Global Compact: human rights, labour standards, environment, and anti-corruption. Pooled Engagement serves as a continuation and escalation of company and stakeholder dialogue.

9	<b>Sector-Based Screening</b> Assesses companies' involvement in sectors and products such as alcohol, animal welfare, cannabis, for-profit correctional facilities, gambling, pornography, and tobacco.
10	<b>SDG Solutions Assessment</b> Determines the positive or negative impact of companies' product and service portfolios on the United Nations' Sustainable Development Goals.
11	<b>ESG Index Solutions</b> Enables investors to identify, benchmark, and track portfolio companies with superior environmental, social, and governance performance and to successfully realize their own indexing strategies. The ESG Index Solutions offering consists of Turnkey Index Solutions and Custom Index Solutions.
12	<b>Cyber Risk</b> Helps investors, insurers and companies to accurately assess, continually monitor, and judiciously benchmark enterprise cyber risk management programs
13	<b>EU Taxonomy Alignment Solution</b> Enables asset managers, pension funds, insurers, banks and other investors to identify the level of alignment of their investments and financial products with defined taxonomy activities and quantify respective revenues in order to comply with the upcoming disclosure obligations.
14	<b>Jurisdiction Ratings</b> Provides detailed information on the sustainability performance of all EU, OECD and BRICS jurisdictions, as well as key sovereign issuers in Asia and South America.
15	<b>ESG Corporate Rating</b> Assesses to what extent companies – now and in the future - are positioned to, on the one hand, adequately manage the specific ESG risks associated with their individual business model and exposure, and, on the other hand, capitalize on opportunities offered by transformations towards sustainable development.
16	<b>SDG Impact Rating</b> Determines a company's positive or negative impact on the United Nations' Sustainable Development Goals across three key pillars: products and services, operations management and controversies.

### *ESG ratings products*

The term “ESG ratings” can refer to the broad spectrum of rating products in sustainable finance and include ESG scorings and ESG rankings.<sup>12</sup> ESG ratings, rankings and scorings serve the same objective, namely the assessment of an entity, an instrument or an issuer exposure to ESG risks and/or opportunities. However, they differ in the resources and methodologies used. ESG scores usually result from quantitative analysis whereas ESG ratings are produced using both quantitative models and qualitative analysis and are accompanied by analyst reports to explain the ratings. Ratings providers select key issues for each ESG component and assess the exposure to these sustainability risks and the way in which they are managed. ESG ratings, scorings, and rankings are usually not defined in absolute terms (although some are<sup>13</sup>) but are generally assessments relative to a peer group.

### *ESG data products*

ESG data products providers have developed a wide range of products and services in order to meet investors' growing demand for ESG-related information. Feedback from providers suggests the potential for innovation remains high. Common ESG data products are explained below:

- **Raw data** is gathered by ESG data products providers from companies' public disclosures or from other publicly available information or collected through

<sup>12</sup> ESG rankings are included here on the basis that the underlying analytical process can be understood as a scoring process for multiple entities or issuers that results in a ranking of entities or issuers in a given sector.

<sup>13</sup> <https://www.sustainalytics.com/esg-data>

questionnaires; if raw data is not available, corresponding data points can be approximated. Feedback suggests that all data products derive from either collected or estimated raw data.

- **Screening tools** assess the exposure of companies, jurisdictions and bonds to ESG risks in order to define a portfolio based on ESG criteria.
- **Controversies alerts** enable investors to track and monitor behaviours and practices that could lead to reputational risks and affect the company and more broadly its stakeholders. Controversies can also be taken into account in ESG ratings.

### *Other ESG products and services*

In addition to the increasing range of ESG ratings and data products, some ESG ratings and data products providers also offer other ESG products and services. These include *inter alia*:

- ESG indices;
- consulting services such as portfolio analysis, advisory services to companies for ESG strategy development;
- provision of certification and second-party opinions;
- regulatory reporting assistance for companies and financial market participants' compliance with new sustainability regulations; and
- advisory services to companies on ESG ratings improvement techniques.

### **Coverage of ESG ratings and data products**

Another important issue is the scope of coverage of the ESG ratings and data products – that is, which companies or instruments do ESG ratings and data products cover, and what is the breadth and depth of ESG ratings and data coverage available from providers. Here, IOSCO provides an initial analysis of the issue broken down into the categories of ESG ratings and ESG data products.

#### *ESG ratings products*

For ratings coverage, the fact-finding exercise showed that while some providers do cover private companies, there is a heavier weighting of ratings coverage for publicly listed companies. This is perhaps unsurprising given that ratings providers rely on public disclosures (and other information) for their analysis. In addition, from a demand perspective, the clients of ESG ratings and data products providers are more likely to invest in publicly listed companies.

<b>Table 5: Example Statements Provided by Stakeholders During IOSCO Fact-Finding Exercise</b>
<b>ESG ratings/data coverage can depend on sophistication of financial market</b>
<i>The individual ESG scores are geographically diverse across developed markets with higher coverage in well-developed markets as data disclosure increases.</i>
<b>Coverage of private unlisted companies less systematic than publicly listed companies</b>
<i>There is [thus] no systematic coverage of private unlisted companies, as there is with publicly listed companies. Two main reasons for this difference appear:</i>
<ul style="list-style-type: none"> <li>• <i>ESG demand in these asset classes is relatively new and there is yet to be sufficient demand for a</i></li> </ul>



*systematic coverage,*

- *Unlisted private companies face fewer obligations in regard to ESG disclosure: direct dialogue appears necessary to gather (de facto internal) information and as such implies a mandate from an investor or lender.*

From a geographic basis, coverage can be considered from two perspectives. On the one hand, coverage delivered by providers is generally weighted towards the “home” financial markets of the providers. But even allowing for this, there is still a weighting in favour of jurisdictions with either sophisticated or developed financial markets, disclosure requirements or both. Meanwhile, mainstream rating methodologies and assessments are generally set against the development stage and regulatory regimes of developed markets, and may not consider appropriately differences when assessing issuers from growth and emerging markets. An overview of one provider’s level of coverage illustrating these aspects is provided in Table 6 below.

<b>Table 6: Sample level of ESG Rating Coverage of publicly listed companies by major geographic region from US Headquartered ESG rating and data provider.</b>									
<b>Products</b>	<b>Coverage by Region</b>								
<b>Carbon Risk Ratings</b>	<table border="1"> <caption>Carbon Risk Ratings Coverage by Region</caption> <thead> <tr> <th>Region</th> <th>Coverage (%)</th> </tr> </thead> <tbody> <tr> <td>AMER</td> <td>33%</td> </tr> <tr> <td>APAC</td> <td>22%</td> </tr> <tr> <td>EMEA</td> <td>45%</td> </tr> </tbody> </table>	Region	Coverage (%)	AMER	33%	APAC	22%	EMEA	45%
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<b>ESG Corporate Ratings</b>	<table border="1"> <caption>ESG Corporate Ratings Coverage by Region</caption> <thead> <tr> <th>Region</th> <th>Coverage (%)</th> </tr> </thead> <tbody> <tr> <td>AMER</td> <td>33%</td> </tr> <tr> <td>APAC</td> <td>22%</td> </tr> <tr> <td>EMEA</td> <td>45%</td> </tr> </tbody> </table>	Region	Coverage (%)	AMER	33%	APAC	22%	EMEA	45%
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<b>SDG Impact Ratings and SDG Solutions Assessment</b>	<table border="1"> <caption>SDG Impact Ratings and SDG Solutions Assessment Coverage by Region</caption> <thead> <tr> <th>Region</th> <th>Coverage (%)</th> </tr> </thead> <tbody> <tr> <td>AMER</td> <td>33%</td> </tr> <tr> <td>APAC</td> <td>22%</td> </tr> <tr> <td>EMEA</td> <td>45%</td> </tr> </tbody> </table>	Region	Coverage (%)	AMER	33%	APAC	22%	EMEA	45%
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<div style="display: flex; justify-content: center; gap: 20px;"> <span><span style="color: red;">■</span> AMER</span> <span><span style="color: orange;">■</span> APAC</span> <span><span style="color: blue;">■</span> EMEA</span> </div>									

### *ESG data products*

Given their reliance on the same raw data inputs, the findings relating to the coverage of ESG ratings products are, to a large degree, replicated for ESG data products. However, given the diversity of products available under this heading, an additional area of interest is which ESG data products are considered by data products providers to be most commonly used, and whether there are regional variations for the popularity of these products.

### *Most popular data product offerings*

A selection of the most commonly offered products from two ESG ratings and data products providers is set out below. Notwithstanding differences in labelling and some commonalities in preferences or screening and ESG related scoring, it is notable that there is some degree of variance between the most popular data product offerings from these two providers. It is possible that these providers are catering to different segments of the market, different regions or to different needs in terms of focus and purpose. It is also possible that the differences may be indicative of the developing market for ESG data, where the balance between the products that clients need and the products that can be provided has yet to be found.

<b>Table 7: Comments Provided by Stakeholders During IOSCO Fact-Finding Exercise</b>	
<b>Comparison of 5 most common ESG data products used by clients of two ESG [rating and] data products providers</b>	
<ul style="list-style-type: none"> <li>• ESG Scores</li> <li>• Daily Monitoring and Alerts</li> <li>• Corporate Physical Climate Risk Scores</li> <li>• Corporate Transition Risk Scores</li> <li>• Controversial Activity Screening</li> </ul>	<ul style="list-style-type: none"> <li>• Sector-Based Screening</li> <li>• Norm-Based Research (NBR) and Sovereign NBR</li> <li>• ESG Corporate Ratings</li> <li>• Controversial Weapons Research</li> <li>• Climate Solutions</li> </ul>

### *Variations in geographic preferences*

Across providers, the popularity of ESG ratings and data products can vary by geographic region, and in some cases, vary within individual jurisdictions. For example, a number of ESG data products providers highlighted that demand for their data products was higher in jurisdictions with a higher level of legislative and regulatory or client focus on ESG investing, namely Europe and the U.S. Furthermore, within Europe, there was a noted preference for certain products in particular countries. To some extent, these preferences can be seen as a combination of investor demand and regulatory requirements, where all jurisdictions have a general level of demand for ESG data arising from client preferences, but certain jurisdictions have more specific demands on the basis of legal requirements.

### *Smaller versus larger institutions*

Outside of Europe and the U.S., respondents highlighted that demand for ESG data products was related to the size of the client, with differences also apparent in the types of ESG data products demanded. Smaller institutions were more likely to subscribe to platforms with scoring information, while larger clients subscribed to databases of raw ESG data.

<b>Table 8: Example Statements Provided by Stakeholders During IOSCO Fact-Finding Exercise</b>
<b>Greater use of ESG data products prevalent in certain jurisdictions</b>
<i>All products are most commonly used in Europe. Norm-Based Research and ESG Corporate Ratings are most popular in this region as it is historically a more European approach to ESG investing. Controversial Weapons Research is particularly demanded in certain European markets with regulations for controversial weapons exclusions. Newcomer markets like Asia are for the time being very focussed on climate. In the U.S., there is a strong demand for raw data, but Sector-Based Screening, Controversial Weapons Research and Climate Solutions are also relatively popular.</i>
<b>Preferences for certain products also exist within jurisdictions</b>

*There are regional variations, which link to historical differences in terms of approach to socially responsible investment. For example, for Europe screening approaches are more prominent in the Nordics, The Netherlands and Germany. Meanwhile, the most advanced market is France. We are also seeing broad interest in Europe and the U.S. for our Corporate Physical and Transition Risk scores.*

## **Public disclosure of ESG ratings and data products**

Practices regarding the public disclosure of ESG ratings and data products can vary significantly, this being dependent to some degree on the providers' remuneration models. In this regard, the public disclosure of fund level aggregate ESG ratings appears more systematic than for company ratings, while non-profit companies tend to make their ratings public. In addition, some ESG ratings providers, when contributing their rating as an input to the design and production of ESG indices, also publish the ratings of the companies included in the indices, although this is not systematic. In the last few years, several ESG ratings providers have published high level ESG ratings of companies on their websites without any paywall.<sup>14</sup>

### **A market which is largely unregulated**

ESG ratings and data products are at an early stage of adoption by financial market participants, although their usage and role are growing rapidly. Consequently, the market remains largely unregulated, with some isolated attempts at self-regulation through codes of conduct. A number of voices (national regulators,<sup>15</sup> industry associations,<sup>16</sup> as well as providers themselves) have called for a regulation of the market.

IOSCO considered the existence of regulatory requirements or voluntary standards in members' jurisdictions. These could provide a real-world example of regulatory or standard setting requirements for these activities or indicate where there may be potential for overlap or conflict with any of IOSCO's proposed recommendations. IOSCO took a bottom-up approach to this scoping exercise, asking the ESG ratings and data products providers whether they were subject to any supervisory or regulatory frameworks. The feedback received did not identify any national regulatory frameworks applicable to these providers, although there did appear to be some voluntary frameworks that had an indirect relevance to providers' activities.

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<sup>14</sup> MSCI, Sustainalytics, Vigeo Eiris, Arabesque

<sup>15</sup> AFM/AMF, French and Dutch financial market authorities call for a European regulation of ESG data, ratings, and related services; ESMA, ESMA calls for legislative action for ESG ratings and assessment tools.

<sup>16</sup> AFEP-MEDEF: French Initiative on the relations between Companies and Non-Financial Rating Agencies

**Table 9: Example Statements Provided by Stakeholders During IOSCO Fact-Finding Exercise**

**Voluntary Frameworks for certain aspects appear to be the norm**

*We strive to avoid any potential conflict of interest or appearance of conflict. Our scores products rely 100% on disclosed data. We consider third party frameworks from NGOs (TCFD, SASB, GRI, CDP), industry associations (IPIECA, American Petroleum Institute, etc.), regulators and standard setting organisations that provide disclosure recommendations, and reconcile with existing disclosure approaches, existing company reported fields and new fields needed for scoring.*

*For actual scores design guidance, we built on the OECD Handbook on Constructing Composite Indicators, among other scoring and evaluation approaches, to (1) attempt to reduce the dimensions represented in scores and therefore noise/risk of distortion (2) incorporate the multidimensional nature of evaluating sustainability performance without losing ability to identify red flags (3) give users transparent access to more complex, granular information and scoring decisions while still aggregating in a way that advances our core principles (e.g., to reward good relative and absolute performance, good disclosure, quantitative reporting and consistent performance across dimensions).*

Some jurisdictions are currently developing frameworks for regulating ESG ratings and data products providers. For example, the European Commission is investigating the market for sustainability ratings and research as part of its 2018 Action plan for sustainable finance.

## Chapter 2: ESG Ratings and Data Products Providers

### Introduction

Whereas Chapter 1 of this Report covered the market for ESG ratings and data products providers, this chapter discusses the practices and experiences of these providers. In particular, this chapter considers how ESG ratings and data products providers source their ESG data and the methods used in the industry. In doing so, it will identify some of the principal challenges in this space. It will also provide an overview of the business models used in the industry.

The observations set out in this chapter are based on sections three and four of IOSCO’s fact-finding questionnaire attached in Annex 1. These questions were directed to providers of ESG ratings and data products, and to companies who have interactions with ESG ratings and data products providers.

### Reliability and availability of Inputs – Raw ESG data

ESG ratings and data products providers rely on data inputs to support their analysis for ESG ratings and data products. The availability of reliable and high-quality data inputs is a critical component of ESG ratings and data products. Depending on a product’s focus, the information relied upon by an ESG ratings and data products provider to assess an entity can be broad. The number of data points used differs from one provider to another, some using thousands of data points. This can include information relating to an entity’s governance framework, financial strategy and management expertise, as well as information on physical and transition climate risks. While ESG-related disclosure requirements are being introduced across some jurisdictions, there remains limited consistency in the disclosures required and their implementation is still at a fairly early stage in most jurisdictions. The WS1 is looking to improve both the consistency and comparability of disclosures as well as introducing a common international baseline through the creation of an ISSB under the IFRS Foundation. As such, in some cases, the information on which ESG ratings and data products are based will be sourced from external entities and third parties, or approximated using internal metrics. Irrespective of how the information is sourced, the quality, reliability, and consistency of this information is an important consideration.

<b>Table 100: Measurement Objectives of Selected ESG Ratings</b>	
<b>Example statements Provided by Stakeholders During IOSCO Fact-Finding Exercise</b>	
<b>Differences in ESG Rating Measurement Objectives</b>	
<b>ESG Ratings Provider 1</b>	<b>ESG Ratings Provider 2</b>
<p><i>Our Sustainability Ratings consider issuers’ multi-stakeholder impact, considering the identification and management of material ESG risks and opportunities and the ability to create long-term value.</i></p> <p><i>ESG ratings can be based on publicly available information only, proprietary information, subscription-based services and information provided by issuers and their management. ESG ratings providers may also offer related and unrelated products and services, including through affiliates.</i></p>	<p><i>[ESG Ratings Provider 2]’s Ratings aim to measure a company’s resilience to long-term financially relevant ESG risks on following aspects:</i></p> <ul style="list-style-type: none"> <li><i>Of the negative externalities that companies in an industry generate, which issues may turn into unanticipated costs for companies in the medium to long term.</i></li> <li><i>Conversely, which ESG issues affecting an industry may turn into opportunities for companies in the medium- to long- term.</i></li> </ul>

### *Difficulties with entities' disclosure practices*

Given the importance of reliable data inputs as a starting point to developing reliable products, IOSCO considered the principal difficulties that ESG ratings and data products providers encounter in sourcing this information. In this regard, the feedback IOSCO received pointed to problems of:

- *availability (varying levels of ESG disclosures)*. More specifically, ESG ratings and data products providers highlighted the low volumes of ESG information in certain regions as a particular issue that can negatively affect the levels of quality and coverage of their products. One provider highlighted the relatively lower volumes of ESG disclosures in emerging markets and the Asia-Pacific region as an example of this issue.
- *inconsistency (format, content and location of disclosures)*. Specifically, disclosed ESG data may be spread across multiple reports of the company, for example, the annual report, corporate sustainability report and individual webpages. While this scenario is preferable to one in which no public disclosures are made, it does create the risk that not all relevant information will be gathered by all providers.

The lack of standardisation of corporate disclosures therefore impacts the quality and availability of information that can be used by ESG ratings and data products providers. These findings are largely consistent with IOSCO's observations from the investor standpoint, namely that sustainability-related information needs are currently not being met, and there is an urgent need to improve the consistency, comparability, and reliability of sustainability reporting.

ESG ratings and data products providers can request or procure ESG information from entities that are the subject of these ratings or data products on a bilateral basis, and in this case, minimise the impact of a number of the above issues. However, where this occurs, there may be risks around transparency, verifiability and ensuring a level playing field for both providers and entities that are the subject of these ratings or data products.

**Table 11: Example Statements Provided by Stakeholders During IOSCO Fact-Finding Exercise**

**Collection of ESG data hampered by multiple factors**

***Low Volume of ESG Information***

*In certain regions and asset classes the total volume of ESG and Climate information (qualitative and quantitative) that is disclosed remains low. Specifically, we see lower volumes of disclosures in Emerging Markets and in the Asia Pacific region.*

***ESG Reporting Fragmentation***

*It is not uncommon to see ESG data and climate information spread across multiple reports (Annual Report, CSR Report, specific website pages or 'deep dives' etc.). That is not negative per se, as we recognize that this information is of interest to multiple parties. However, consolidation within one primary document, a main section of a report, or a main section of a website would reduce the risk of lost information indicators on whether or how progress is being made against the policies.*

***Issues with Supporting Information for Targets***

*Where targets are set on ESG or Climate issues, we observe that baselines are not always made clear, and that progress on these targets (on track/off track information) is rarely provided.*

***Lack of Key Performance Indicator (KPI) Consistency***

*We also observe that where metrics or KPIs are provided by entities, restatements of prior figures are not always made clear; time series data is not always made available; and that the scope of the data is not always made clear.*

IOSCO is working with the IFRS Foundation to support the establishment of an ISSB which will develop a common set of international standards for sustainability-related disclosure across jurisdictions and form the basis for the development of an audit and assurance framework.<sup>17</sup> Over time, this type of standardisation will also likely mitigate the other issues identified through IOSCO’s fact-finding exercise.

*Remuneration: “Issuer Pays” versus “Subscriber Pays” model*

Feedback from respondents to the fact-finding exercise indicates that the fee model for ESG ratings and data products is largely, although not exclusively, based on a “subscriber pays” basis. While there are some examples of the “issuer pays” model from certain providers, these are mostly focused on ESG ratings. Where figures in terms of ratio of revenues from “subscriber pays” versus “issuer pays” were provided, these put the split at between 85% and 100% of revenues being derived from “subscriber pays”. This mix has been described as being relatively stable over a number of years and no respondents to the fact-finding questionnaire noted a shift in recent years. Nevertheless, a shift towards greater use of an “issuer pays” model could occur in the ESG ratings and data products space, as a result of many potential factors, such as upcoming regulation and evolving market practices. For example, if the incentive or financial benefit for an issuer to be the subject of an ESG rating or data product were to increase, this would increase the financial benefit or incentive for an issuer to pay for the ESG rating or data product.

Depending on the remuneration model put in place, the potential risks of conflicts of interest will differ. While the “subscriber pays” model may not raise the same concerns as those which have been observed with the issuer pays model, there are a number of other issues related to this being the dominant business model. First, if ESG ratings and data products are provided on a “subscriber pays” basis, smaller investors may be at a disadvantage, as their ability to subscribe to multiple product packages will likely be constrained by cost. Even if an investor were to have the ability to subscribe to a single product package, without the ability to understand the underlying data inputs and methodological approach, the investor may not be able to make an informed choice between product offerings.

It is useful to note that ESG ratings providers are increasingly providing their high level ESG scores on their websites for public access. On that basis, smaller investors would still have access to some ESG ratings as well as to the sustainability-related disclosures of listed companies.

Finally, the “subscriber pays” model potentially creates pressure for the provider to prioritise quantity of information over quality of information. Indeed, users of ESG ratings and data

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<sup>17</sup> IOSCO press release dated 24 February 2021.

products will seek access to broad coverage across geographies and sectors, possibly putting pressure on the provider to deliver this coverage even where availability and robustness of underlying data are not sufficient or lead to declining overall quality of analysis.

<b>Table 12: Example Statements Provided by Stakeholders During IOSCO Fact-Finding Exercise</b>
<b>ESG data fee’s model is predominantly “subscriber pays”</b>
<i>[ESG Ratings and Data Provider] ESG Research business model is not an issuer pays business model and issuers do not pay for their ratings. However, issuers can subscribe to [ESG Rating and Data Products Providers] ESG Ratings, our flagship offering, in order to benchmark their ESG practices against industry peers.</i>
<b>But market could shift in coming years</b>
<i>The subscriber pays vs. issuer pays revenue mix has been stable for several years. We are cognizant of the fact that many factors could lead to a tilt at some point (upcoming regulation and market practice, as evidenced by the way Credit Rating Agencies have seen their business model evolve over the last decades).</i>

## Methods used in the industry

### *Interactions with companies*

While ESG ratings and data products providers rely on a broad range of sources for gathering information, one of the most significant sources for a number of providers is the information gained from entities that are the subject of these ratings or data products. There is no “standard” market practice for the manner in which ESG ratings and data products providers gather information from entities that are the subject of these ratings or data products.

The nature and frequency of these interactions can differ depending on the business model or/and proprietary methodologies of ESG ratings and data products providers. For example, some ESG ratings and data products providers only engage with the entities that are the subject of these ratings or data products at a late stage of the rating process. In this case, the ESG ratings and data products provider would refer to publicly available data for its analysis and thereafter engage with the entity subject to assessment to check the accuracy of the data or/and to receive feedback on the assessment performed. However, this is not the only approach and some respondents to the fact-finding exercise noted that they prefer to engage in a more continuous relationship with the entities they assess. Some, for example, employ questionnaires to gather information from entities. Even then, the frequency and depth of these interactions differ widely according to the methodologies, policies and procedures in place at the ESG ratings and data products providers.

### *Methodological approaches and transparency*

The methodological approaches underlying ESG ratings and data products are very diverse, which, when combined with issues regarding the availability, quality and comparability of ESG data, can result in low correlation and high divergence in ESG ratings and data products between providers even where products are aiming to address the same objective.<sup>18</sup>

<sup>18</sup> Berg, F., J. F. Koelbel, and R. Rigobon (2020): “Aggregate Confusion: The Divergence of ESG Ratings”, *MIT Sloan School Working Paper*; Christensen D., G. Serafeim and A. Sikochi (2019): “Why is corporate virtue in the eye of the beholder? The case of ESG ratings,” *Harvard Business School Working Paper*; Chatterji K., R. Durand, D. I. Levine, and S. Touboul (2016): “Do ratings of firms converge? Implications



A recent report by the OECD describes some of these differences in methodologies among providers:<sup>19</sup>

- Data may be collected according to methods specific to each provider and can result in the combination of information from a variety of sources:
  - Information publicly reported by companies or published by third parties such as press agencies, non-governmental organisations, or other sources of information.
  - Questionnaires sent directly to assessed companies.
  - Data produced or gathered by third party suppliers through subscriptions or partnerships.
- Data used may be presented as collected (raw), aggregated, processed in order to be usable (cleaned) or even estimated.
- Processes for verification and update of data may vary among providers. In some cases, the information collected may be supplemented, specified or corrected through discussions with the assessed companies.
- In other cases, a lack of reporting can either lead providers to use industry averages, thereby possibly creating an incentive for poor performers not to report their information, or lead the provider to negatively assess the company.
- The weight given to quantitative and qualitative analysis varies from one ESG ratings and data products provider to another. Some give particular importance to qualitative information, while others base their analysis mainly on figures and quantitative models. The number and role of analysts can vary, depending on the business models and products and services offered.
- Methodologies may vary in the number of data points, indicators or KPIs used to measure an issue (which can amount to hundreds, or, in some cases, thousands) and, in the case of scorings and ratings, the weighting applied, between different pillars (environmental, social and governance) and different sub-categories and indicators; methodologies are generally reviewed on an annual basis.
- Ratings may vary in their finality, with a focus on performance or risks, or have different approaches to materiality. For example, some ESG ratings measure a company's exposure to ESG risks and others measure the impact of ESG factors on an entity.

This challenge can be further exacerbated where little transparency exists about methodologies for users of these products, noting in addition that the differences observed for corporates are likely to be observed for other entities that are the subject of these ratings or data products, such as sovereign issuers, or products, such as investment funds, although information is still scarce on these segments.

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for managers, investors and strategy researchers”, *Strategic Management Journal*; Kotsantonis S. and G. Serafeim (2019): “Four Things No One Will Tell You About ESG Data”, *Journal of Applied Corporate Finance*.

<sup>19</sup> See, OECD (2020), *ESG Investing: Practices, Progress and Challenges*, OECD, Paris.

### *Use of sector-specific methodologies*

ESG ratings and data products providers predominantly use sector-specific methodologies and risk assessments, rather than one single methodology that is applied to all entities that are the subject of these ratings or data products. A large majority of fact-finding respondents indicated that they use both general and sectoral metrics in their assessments, weighting them in different ways depending on the final product. For example, the vast majority of ESG ratings and data products providers use a standard set of “universal ESG metrics/measurements” from a cross-sectoral approach, complemented by more ad-hoc metrics, depending on either the industry in which the assessed entity is active, its geographic location, or its size.

In addition, the nature of the indicators or criteria used might depend on which ESG criteria is applied. For example, there seems to be a general level of consensus with respect to governance (G) criteria, which tend to include a more limited set of metrics that are considered relevant regardless of the size or sector of the entity subject to assessment. In contrast, the social (S) and environmental (E) criteria appear to be applied in a less universal way, allowing for more industry or size-specific metrics to reflect the diverse nature of material issues to be dealt with in these two aspects of ESG ratings and data products.

<b>Table 133: Example Statements Provided by Stakeholders During IOSCO Fact-Finding Exercise</b>
<b>Use of Sector- Specific Methodologies for ESG ratings and data products</b>
<i>The ESG methodology blends components which can be applied across all sectors with sector- specific sustainability factors. The need for sector- specific factors reflects the very different ESG risks and opportunities profile depending on the sector. The relevance of sub-factors can vary considerably by industry as well as the key performance indicators we use. Having sector specific indicators does not prevent the ESG Evaluation from having a globally and cross sector consistent approach. The way we achieve cross sector comparability is by using different starting points depending on the sector and jurisdiction in which the entity operates in and complementing this information with a relative analysis of the entity ESG performance compared to its sector.</i>

### *Use of data collection tools*

IOSCO also looked at the state of play with regard to ESG ratings and data products providers’ use of machine learning (ML) and artificial intelligence (AI) techniques. Feedback from the ESG ratings and data products providers indicates heterogeneous practices in this area, both in regard to the state of progress and the present or future uses of AI and ML.

For example, while some providers have based their business practices around the application of AI and ML techniques to improve their data collecting, research, or/and indexing processes, other providers are still assessing how AI and ML can supplement existing practices. The feedback received by IOSCO indicated significant differences in the projected implementation of these capabilities, with the majority of respondents emphasising that they were still at the prototyping/pilot stage of deploying these capabilities.

Uses (whether actual or intended) of AI and ML were almost unanimously flagged as mainly for the support of human analysis and would in no case act as a substitution to the work currently being performed by human analysts. Such AI/ML help would allow for more frequent updates of the data or for more convenient data collection processes, therefore freeing human resources for more valuable tasks such as analysis, making recommendations and determining outcomes.

While AI and ML have a role in simplifying the data compilation process, other uses have also been observed. These include using AI and ML techniques for the purpose of assessing sentiment and behaviour of the market towards key ESG issues, or to provide estimates of historical carbon emissions.

<b>Table 144: Example Statements Provided by Stakeholders During IOSCO Fact-Finding Exercise</b>
<b>Use of artificial intelligence and machine learning techniques evidenced but still at early stage</b>
In recent years, we have been utilizing Natural Language Processing to a greater degree, which improves efficiency in data extraction and enables us to cast a wider net when processing news and media data sources. With the increase in ESG data requirements and with more companies and third parties reporting relevant data, we are collecting more data points for more companies now than 2 years ago. Machine Learning and Natural Language Processing capability helps us tackle increased volume and scope of publicly available data. Please note that the technology is used to assist research process, but not substitute it.

### *Conduct of due diligence by ESG ratings and data products providers*

The fact-finding exercise revealed a wide range of due diligence practices performed by ESG ratings and data products providers. The practices for due diligence tended to differ depending on the nature of the ESG-related information and the channel through which it has been obtained.

For example, information that is gathered through publicly available sources would first be compiled in bulk for an entity before being reviewed by the ESG ratings and data products providers. This “quality-check” stage would then assess the information according to the providers’ methodology. These checks can include, depending on the process: scrutinizing for plausibility, screening for potential incoherencies, statistical and logical checks (looking for abnormal spikes and outliers, either at the company or/and at the industry level), validation against other sources such as governmental databases, and deviations against a peer group or against previous years.

When potential incoherencies are flagged during the due diligence process, ESG ratings and data products providers generally favoured dialogue with the assessed entities to confirm or inform the KPIs/metrics.

<b>Table 155: Example Statements Provided by Stakeholders During IOSCO Fact-Finding Exercise</b>
<b>Due diligence of ESG ratings and data products providers</b>
<i>Information disclosed by companies is generally scrutinized for plausibility by analysts. In case of well-founded reasons to doubt the veracity or accuracy of data based on contextual information, it will not be considered for performance assessments, or only after verifying the credibility of the content in dialogue with the company.</i>
<i>Similarly, inconsistencies in reporting are thoroughly screened for the reason of apparent inconsistent information (e.g., different scope of reporting period of various company publications). If it cannot without doubt be determined which information is correct or the most comprehensive, it will not be considered performance assessment, unless all doubt can be eliminated through company dialogue. Additionally, the quality and scope of external assurance of a company’s sustainability/ESG reporting is assessed in a dedicated data point, as is the case for GHG emissions inventories.</i>
<i>For climate data (emission reported) used in our climate offerings there is also a plausibility check. If data is not deemed plausible, it is estimated instead.</i>

### *Benchmarking against other providers*

A final methodology question was the extent to which ESG ratings and data products providers benchmark the performance of their products against those of other ESG ratings and data products providers. Here, respondents were unanimous in stating that they did not compare their own analyses with those of their competitors. In some respects, this is a positive aspect of market behaviour and indicates that providers' assessments are not influenced by a desire to coalesce around a common market view. However, there is also likely a practical reason for this, in so far as if their methodologies and products are inherently different, are not disclosed, or have different measurement objectives, then benchmarking is not feasible.

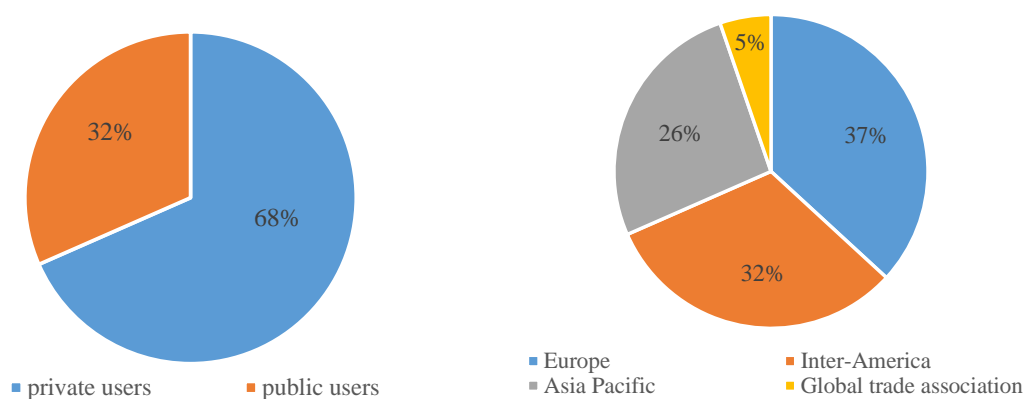
<b>Table 166: Example Statements Provided by Stakeholders During IOSCO Fact-Finding Exercise</b>
<b>Use of benchmarking against other providers</b>
<i>[ESG ratings and data products provider] does not directly compare its ESG ratings to that of other ESG Ratings providers. As discussed previously, the methodologies used can be different in scope and content, and do not necessarily aim at measuring the same elements.</i>

## Chapter 3: Private and Public Users of ESG Ratings and Data Products

### Introduction

The purpose of this chapter is to focus on private (asset or fund managers and corporate users) and public (public pension funds, central banks, and government-owned financial institutions) sector users of ESG ratings and data products. This chapter summarises some of the views provided mainly by large private and public users. These views include the mandate under which ESG ratings and data products are used, how this information is consumed by these users, whether and how they conduct due diligence on this information, and whether they identify any issues regarding governance and management of conflicts of interest.

During the fact-finding exercise, IOSCO received feedback from 19 user organisations (13 private users and 6 public users). In terms of regional representation, 37% of participants were from the European region, 32% from the Inter-American region, 26% from the Asia Pacific region. The rest of the responses (5%) came from global trade associations, as illustrated below.



Given the growing role of ESG ratings and data products in the investment decision process or investment ecosystem, IOSCO predominantly collected views from users in light of their investment purposes.

### Overview of findings

#### *Variation of objectives for using ESG ratings and ESG data products*

The fact-finding exercise indicated that most respondents use ESG ratings, albeit for diverse objectives. Some asset managers mentioned that they use ESG ratings to integrate ESG factors in their investment process, manage sustainability exposure and/or opportunities of their investment portfolio, or develop and oversee sustainable products. One asset manager uses ratings to guide its stakeholder engagement strategy with invested companies or produce ESG reports for clients. One asset owner uses ESG ratings to monitor external asset managers as a trustee by assessing their exposure to ESG, and more specifically, climate risks.

Participants were asked about how ESG ratings are incorporated into their investment decisions or other perspectives. Most respondents indicated that ESG ratings are generally incorporated into investment decisions, but did not describe how ESG ratings are used in investment decision-making processes. Some institutions noted that ESG ratings are not systematically

included in all investment decisions, but rather that ESG ratings are used to reinforce internal analyses and investment decisions by helping to identify risks and opportunities.

As for ESG data products, views provided during the fact-finding exercise were to some extent different from those on ESG ratings. The responses highlighted that slightly more participants use ESG data products than ESG ratings. Managing sustainability risks or opportunities was a common objective, however, broader objectives including negative screening, the development of sustainable product offerings and regulatory reporting were mentioned. Some asset management firms indicated that they mainly use ESG data for environmental analysis such as monitoring the alignment of investment portfolios to the Paris Agreement.

Most respondents use both ESG ratings and ESG data products and have contracts with a variety of large providers. This is because the scope, coverage or areas of specialisation of ESG data products and expertise of ESG ratings or data products providers are different. In this regard, one asset management firm noted that by using more than one ESG ratings or data products provider they are able to gain a more comprehensive ESG perspective. A few asset managers are using ESG data but not external ESG ratings, which they view as not fit for their purpose. This may result in the development of in-house ESG ratings rather than relying on external ESG ratings. (Please see the following section for more details.)

<b>Table 17: Objectives of using ESG ratings and ESG data products</b>	
<b>ESG ratings</b>	<b>ESG data products</b>
<ul style="list-style-type: none"> <li>• Manage sustainability-related risks or opportunities</li> <li>• Design and oversee sustainable products</li> <li>• Guide engagement strategies that drive positive change in the invested companies</li> <li>• Guide corporate sustainability initiatives</li> <li>• Report to clients</li> <li>• Monitor external asset managers as trustee by assessing the exposure of ESG and climate risks</li> </ul>	<ul style="list-style-type: none"> <li>• Manage sustainability-related risks or opportunities</li> <li>• Meet compliance with CSR policy</li> <li>• Negative screening (e.g. products that provide names of companies producing weapons)</li> <li>• Offer sustainable investing products</li> <li>• Meet regulatory reporting requirements</li> <li>• Analyse environmental impacts (e.g. GHG emissions, carbon intensity, monitoring the alignment of the financial portfolio to the Paris Agreement)</li> </ul>

### *Reliability of ESG ratings and data products*

Reliable ESG ratings and data products are important, particularly for users such as institutional investors to inform their investment decisions. Given the practice that ESG ratings or ESG data are generally provided to users in accordance with the contract terms under an “investor-paid” basis (Please see Chapter 2), users have a vested interest in the quality of ESG ratings and data products. Further to this, IOSCO sought views on whether and how private and public users conduct due diligence or verification of ESG ratings, data products and these providers.

Responses to the questionnaire revealed that users generally do not conduct any formal verification of the ESG ratings and ESG data products. Some asset managers noted that they may engage with ESG ratings or ESG data products providers on an ad-hoc basis when they observe an inconsistency between the ESG ratings or ESG data products and their own analysis. However, it is noted that all public users, and some private users, responded that they do not

implement verification processes on raw ESG data underlying ESG ratings or ESG data products because such processes are resource intensive and may not be possible with available information.

The fact-finding exercise indicated that there are generally similar factors impacting reliability of ESG ratings and ESG data products. Most organisations pointed out the lack of transparency of methodologies including aspects such as the scope of the underlying data, definitions of materiality, the timing of data collection and the frequency of review or update of the ESG ratings or ESG data products. Of note, one respondent mentioned that the evaluation criteria of ESG ratings and data products are a “black box” and whilst it should be transparent, the models used could be confidential to the extent that they are considered to be intellectual property developed by ESG ratings and data products providers.

With regard to the underlying ESG data, the more fundamental issue raised concerned the need for improvements to corporate disclosures. Some respondents pointed out that standardisation of corporate-level ESG disclosure would increase availability of raw ESG data used for development of ESG ratings or data products. In addition, these respondents encouraged third-party assurance which would increase the reliability of the data. These views are consistent with the observations and priorities of IOSCO’s work on sustainability related issuer disclosure, as already noted in the Introduction and Chapter 2 of this Report.

Furthermore, most respondents outlined that they tend to conduct an assessment on the ESG ratings or ESG data products providers rather than on the ESG ratings and data products. Some asset managers carry out due diligence of new ratings or data products providers at the initial on-boarding stage by reviewing how these providers manage the ratings or data gathering and quality control process. The Table below shows the summary of approaches to due diligence by users.

<b>Table 178: Examples of approaches to due diligence</b>	
<b>Before the agreement with providers</b>	<b>After the agreement with providers</b>
<ul style="list-style-type: none"> <li>• Check quality control processes</li> <li>• Check governance and transparency of providers by visiting providers’ offices and conducting Q&amp;A session (e.g. to check whether internal processes to build methodologies are well governed)</li> </ul>	<ul style="list-style-type: none"> <li>• Go back to data sources (e.g. annual reports) when identifying data discrepancy or abnormal data</li> <li>• Engage with providers when identifying defective data to check to what extent data products reflect the current practices of entities</li> <li>• Ask providers for clarification/further information about the result of ESG ratings</li> </ul>

### *External ESG ratings vs internal ESG ratings*

One key takeaway from the roundtable is that the lack of transparency around external ESG rating methodologies is a key factor in encouraging users to build proprietary rating methodologies. IOSCO’s questionnaire revealed that almost all large asset managers are using or currently developing their own ESG ratings to supplement, or form part of their investment processes. Most respondents argued that the wholesale adoption of third party ESG ratings and their methodologies might not align with their investment strategies, although a minority of

respondents indicated that using external ESG ratings could save them time with regards to their own analyses.

Most asset managers tend to develop internal ESG rating systems customised to their specific investment strategies and philosophies. One example of developing internal ESG ratings is to identify ESG criteria that are relevant for the sector(s) in which the asset manager is seeking to invest, before constructing a methodology underpinned by these criteria. Another example is to select a limited set of KPIs to be considered by the asset manager as part of its review of the performance of underlying portfolio companies. Conversely, none of the public users indicated that they are using, or have plans to develop, proprietary ESG rating methodologies.

In addition, participants in the fact-finding exercise were asked whether they benchmark their internally developed ESG ratings against external ESG ratings. Most of them responded that they did not assess external ESG ratings against their own in-house ESG ratings because of the different methodologies used.

Furthermore, users noted a tendency to reduce their reliance on externally provided ESG ratings. Some respondents are generally working towards building capacity and upskilling to develop in-house capabilities. They also indicated a preference to rely on externally provided ESG data from providers rather than externally provided ESG ratings while they are in early stages of developing proprietary capabilities. One organisation raised the view that using ESG data products from a recognised provider was beneficial because ESG information is not disclosed consistently.

On the other hand, producing proprietary internal ESG ratings may not be feasible or cost effective for small or medium sized asset managers. Discussions at the roundtable showed that these managers often have limited capabilities and resources available for analysing external ESG ratings or developing in-house ESG ratings. Moreover, as described in the section above, large asset managers tend to have contracts with several ESG ratings or data products providers to gather different perspectives of entities' ESG profiles for their internal processes, however, small or medium sized firms are unable to do so largely due to budget constraints.



## Chapter 4: Companies and ESG Ratings and Data Products Providers

### Introduction

This chapter explores how ESG ratings and data products providers engage with companies and the challenges these companies may face when providers seek more specific data and in their general communications with these providers.<sup>20</sup>

The observations set out in this chapter are based on sections one and three of IOSCO's fact-finding questionnaire attached in Annex 1. These questions were directed to companies who have interactions with ESG ratings and data products providers, with the aim of developing a better understanding of their level of interaction with ESG ratings and data products providers, the difficulties they may face in engaging concurrently with several providers and the overall transparency of communications on data products or ratings affecting them.

### Overview of key findings

#### *The level of interactions between companies and ESG ratings and data products providers*

Generally, there are three phases during which companies can interact with ESG ratings and data products providers: (1) data collection, at which point the ESG ratings or data products providers will typically reach out to a company to request information that will assist with its ESG ratings or data product, (2) data assessment, during which the ESG ratings or data products providers use all the information they gather pursuant to their methodology to determine their ESG ratings or data product, and (3) pre-publication of the final ESG ratings or data products, where the ESG ratings or data products provider may inform the company of the outcome of its assessments, and in some circumstances, provide the company with the opportunity to offer additional information which may alter the assessment.

The following sections explore the challenges faced by companies in more detail. However, it is worth highlighting that, in many cases, most of the engagement between ESG ratings and data products providers and companies occurs during the data collection and the data assessment phases. Based on the feedback received during the fact-finding exercise, the engagement tends to be more limited during the pre-publication phase, and where it takes place, it often happens at the request of the companies in order to address any errors or omissions related to the use of the companies' information.

#### *i. Phase 1: Data collection – time consuming for companies*

A majority of respondents expressed concerns that data requests from ESG ratings and data products providers are time-consuming because of the number and frequency of the questions set out in the questionnaires. For example, where a company receives multiple requests for information with limited or no ability for forward planning, this creates a risk that there will be a poorer quality of response. This is an unwanted outcome for both companies and ESG

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<sup>20</sup> IOSCO's fact-finding exercise mainly covered the interaction of companies with ESG ratings providers but also collected views on the interaction with ESG data products providers. Issues identified in terms of interaction with ESG ratings providers exist in the context of interaction with ESG data products providers.

ratings and data products providers as it may require allocation of additional resources to deal with any follow-up questions to address errors or omissions.

Another challenge highlighted by companies was the timing of the questionnaires. For example, each ESG ratings and data products provider may decide the timing of data requests to companies that are the subject of these ratings or data products according to their own internal timeline. This could cause requests to companies with different timings from different providers. Respondents suggested that ESG ratings and data products providers could consider whether it would be feasible, without affecting the timeliness, accuracy and independence of their reviews and subsequent ratings or data products, to communicate to companies when their ESG ratings and data products will be subject to review. Respondents suggested that this could enable companies subject to assessment to allocate resources in advance of when they are needed. Respondents also noted that, if all providers published the expected timelines for their requests, again if possible and without diminishing quality, timeliness and independence, this approach could provide more predictability than currently appears to be the case.

Finally, the context for some of the questions to which companies are asked to respond within the questionnaires can sometimes be unclear to companies, who are left confused as to how the data they provide will be used by ESG ratings and data products providers in making their assessments, or by investors in their decision-making process. One company noted that there are cases in which additional questions are asked without sufficient explanations or reasons from providers. In terms of providers' resources, another company pointed out that the high turnover of analysts and the need to bring them up to speed each time is a significant resource strain for companies.

*ii. Phase 2: Data assessment – lack of transparency of evaluation methodology*

Respondents to IOSCO's fact-finding exercise highlighted the lack of engagement and transparency from ESG ratings and data products providers with the companies throughout the data assessment and evaluation process. For example, as mentioned in Chapter 3, one respondent categorized the whole evaluation phase by the ESG ratings and data products providers as a "black-box" even if some aspects of the methodology are disclosed.

This can create challenges for the companies as they may not always understand how the ESG ratings and data products providers have reached their outcome, making it difficult for them to amend their business models and practices in order to receive better ESG scores, ratings or other product outcomes.

As such, many respondents called for increased transparency and explanations/disclosures of the methodologies used by ESG rating and data products providers, including the ESG factors used, the weight of each factor, absolute or relative scoring, materiality, and industry ranking considerations.

Moreover, even where methodologies may be more transparent, companies pointed out that some ESG ratings and data products providers change their methodologies relatively often without prior notification to either companies or market participants. This can increase difficulties in comparing how a company has performed over time and result in confusion for both market participants and companies, particularly where the methodologies are not published.

Finally, some companies believe that ESG ratings and data products providers sometimes give a ‘failing grade’ or a negative result for not providing the data which they requested, without having disclosed the fact that not providing a particular data set can influence the rating or outcome that will be given to the company. Some companies suggested that questionnaires should provide space to describe why the data was not provided or simply show that a specific data set was not available. This could prevent ESG ratings and data products providers from giving a ‘failing grade’ or negative outcome without any explanation.

<b>Table 19: Views of companies regarding interaction phase 2: Data assessment</b>
<ul style="list-style-type: none"> <li>• Lack of transparency of the rating or data product methodology and criteria (the “black-box”; ESG factors, weight, absolute and relative scoring)</li> <li>• Limited explanation of the outcome</li> <li>• Interpretation of the ranking or outcome</li> <li>• Ranking or assessment criteria</li> <li>• Limited explanation of the final assessment</li> <li>• Change of rating or data product methodologies without publication or notification</li> </ul>

*iii. Phase 3: Pre-publication – lack of opportunity of review prior to publication*

A majority of respondents highlighted the lack of interaction between companies and ESG ratings and data products providers ahead of the publication of the final ESG rating or data product report, suggesting this interaction often only took place at the request of the company themselves.

Where interaction takes place, companies noted that they were sometimes asked to pay to gain access to the report. This is also seen at the post publication phase. Given the current “subscriber-pay” model, in general there is no specific incentive for the ESG ratings or data products providers to interact meaningfully with the companies.

This lack of interaction leaves companies with limited opportunity to check the accuracy of the content of the final report, meaning they are unable to indicate factually incorrect or insufficient information in a timely manner. This is particularly the case where, as usually happens, investors receive the final report on the ESG rating or data product ahead of the companies. This creates potential reputational risks for the companies, and could possibly lead to poor investment decisions on the part of the investor paying for and using ESG ratings or data products that are based on erroneous or limited information.

<b>Table 20: Views of companies regarding interaction phase 3: Pre-publication</b>
<ul style="list-style-type: none"> <li>• Lack of possibility to get the final report for free making it difficult for the company to provide comments or corrections in a timely manner</li> <li>• Lack of opportunity to amend incorrect information</li> <li>• Tight deadline for review</li> <li>• Ineffective amendment after publication of final report</li> <li>• Risk of investment decision based on inaccurate information without review in advance of publication</li> </ul>

### *Potential conflicts of interest*

As mentioned above, ESG ratings and data products providers sometimes require companies to pay for something related to rating or assessment processes, especially for the access to the final rating or data products report at the pre-publication phase.

In addition, as described in Chapter 1, ESG ratings and data products providers may offer other types of services, notably to companies with regard to their ESG performance. These services can, for example, include consulting services such as portfolio analysis, the provision of certification and second-party opinions as well as advisory services on corporate ESG strategy. In certain cases, it can include support such as insight into how ESG ratings and data products are developed or support with reporting that influences ESG ratings and data products (e.g. review of responses to providers' questionnaires, guidance on how to improve the quality of reporting). Some ESG ratings and data products providers also offer regulatory reporting assistance to help companies and financial market participants comply with new sustainability regulations while others, in addition to providing ESG ratings or data products, advise companies on how to improve their ESG ratings or data products. This could result in conflicts of interest where the consulting side of business may provide information to the company to allow said company to gain an advantage in terms of receiving a good rating or data product outcome from the ESG rating or data product side of the business. This type of potential conflict of interest was highlighted as another potential concern by users of ESG ratings and data products.

In this regard, some respondents observed that some ESG ratings and data products providers are seeking to identify and mitigate the risk of conflicts of interest. For example, one response mentioned that some global ESG ratings and data products providers are separating the function between ESG ratings or data products and indices to ensure their independence and transparency. IOSCO received limited information from respondents about good practices by ESG ratings and data products providers to avoid potential conflicts of interest.

## Chapter 5 Proposed Recommendations

### Introduction

Before determining whether it was appropriate for IOSCO to propose recommendations in this area, IOSCO canvassed the opinions of stakeholders to understand: (i) whether developments in the area of ESG ratings and data products providers pose risks to investor protection; (ii) whether there are already existing standards or guidance in the market for ESG ratings and data products providers; and, (iii) whether there would be value in IOSCO playing a role to provide this guidance.

To receive feedback on this issue, IOSCO addressed specific questions to stakeholders during the fact-finding exercise. IOSCO asked ESG rating and data products providers to identify practical steps that could be taken to improve the usability and reliability of the information companies currently disclose. Respondents suggested the following:

- companies could, to the extent possible, use one existing report as their primary form of ESG disclosure, such as an annual sustainability report. Respondents noted that this would help place the reporting of ESG data on par with financial data.<sup>21</sup>
- companies could work to ensure consistency of the KPIs referred to in these reports, for example by making clear where figures are being restated from a previous year, making clear the scope of the figures that are being presented, and providing time series information where possible.
- More transparency about the timing of disclosures and dialogues with ESG rating and data products providers. For example, respondents suggested that if, at the start of the year, companies were to publish a calendar for when and where their ESG disclosures were to be made, this would help ESG rating and data products providers align their review frequencies with the availability of information.
- more dialogue between companies and ESG ratings and data products providers to understand when ESG ratings and data products will be subject to review/update to ensure both are aware of when engagement may be beneficial to address information gaps, or errors/omissions in ESG rating and data products.

Based on the fact-finding exercise, IOSCO believes that there are some areas that could be improved from the users' perspective.

#### *Reliability of raw ESG data*

Raw data is a key factor to determine the quality of ESG ratings and data products. Given that the quality of raw ESG data relies to a large degree on the quality of corporate disclosure, most users expect that improvements in the quality of corporate disclosures would contribute to enhancing the consistency of ESG ratings and data products. This could also contribute to improving the availability of raw data, which would allow users to directly access data points to access raw data.

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<sup>21</sup> As stated in IOSCO's press release of 24 February 2021, IOSCO aims to promote closer integration with financial reporting and independent assurance of companies' disclosures.

### *Lack of transparency around ESG ratings methodology and ESG data products*

In addition to having good quality underlying raw data, the quality of ESG ratings depends on the robustness of ESG rating methodologies. Likewise, for ESG data products, data collection, frequency and verification will impact data quality. Lack of transparency on the process of developing ESG ratings and ESG data products could make it difficult for users to understand and interpret providers' outputs.

### *Reliability of ESG ratings and data products and potential conflicts of interest*

To help users make more informed investment decisions, reliability of ESG ratings and data products is a key issue. This relates primarily to ESG ratings and data products providers having robust and transparent governance processes around business models and fee structures, conflicts of interest policies, and quality management systems. This could include, for instance, explicit measures to ensure independence and separation of ESG ratings and data products and consulting services.

Where ESG ratings and data products providers also receive fees related to other services such as consulting services from companies, potential conflicts of interest could arise from such interplay of services. Most respondents suggested that there should be procedures in place at the level of the provider to separate the staff responsible for ESG ratings and data products from the staff providing consulting services.

### *Communication between ESG ratings and data products providers and companies*

As noted in Chapter 4, the lack of interaction between ESG ratings and data products providers and companies exists in the three different phases of the providers' process to varying degrees. The data collection process could be improved through more transparency about the timing of the questionnaires, pre-filled baseline surveys with historical or publicly available information to assist resource-constrained companies and more transparency about how the requested data will be used by the ESG ratings or data products provider.

Respondents suggested that ESG ratings and data products providers could consider submitting a copy of the company's last completed questionnaire for the company to update. Respondents noted that this could likewise reduce the effort required on the part of the company subject to assessment and could enable it to focus its efforts on verifying the accuracy of the available information or updating information where needed.

In the 'data assessment' phase, the lack of transparency behind the factors and criteria that underpin methodologies has raised concerns amongst companies. Similar to the feedback received from users of ESG ratings and data products, some companies have asked for clearer and more transparent disclosure of information on how an ESG rating or data product is derived and the opportunity to correct any erroneous information through ongoing dialogue.

In the 'pre-publication' phase, the seeming lack of opportunity given to companies to correct any errors could lead users to make investment decisions based on erroneous information.

As a result of these challenges, respondents to the fact-finding exercise were of the view that providers should engage more actively with companies once they have finalised their

assessment, before publication, rather than wait for the company to approach them to rectify any potential error or provide additional information. In this regard, it should be noted that there is a potential risk of conflicts of interest in the interaction between ESG ratings and data products providers and companies.

### *Support for IOSCO Guidance*

There was clear support from stakeholders for IOSCO to provide guidance that addressed a broad spectrum of ESG ratings and data products. This spectrum ranged from recommendations addressing the internal processes of the providers themselves, the uses and users of the products, as well as interactions between covered entities and the providers. On this basis, IOSCO has proceeded with proposed recommendations addressing the key areas of concern.

Based on these specific suggestions and stakeholder feedback received from the fact-finding exercise conducted by the STF, this chapter sets out proposed high-level recommendations and possible action points for meeting the objectives of the proposed recommendations.

The proposed set of recommendations are provided according to 5 sections:

- Section 1 provides proposed recommendations on possible regulatory and supervisory approaches.
- Section 2 provides proposed recommendations on the internal processes of ESG ratings and data products providers.
- Section 3 provides proposed recommendations concerning the use of ESG ratings and data products.
- Sections 4 and 5 provide proposed recommendations concerning the interactions of ESG ratings and data products providers with entities subject to assessment by ESG ratings and data products providers.

How these proposed recommendations could be implemented will depend upon the priorities of stakeholders, local market circumstances and individual jurisdiction's legal and regulatory systems. For their part, ESG ratings and data products providers, and entities covered by ESG ratings and data products providers, may wish to consider inclusion of the relevant provisions in their internal policies and procedures. In some cases, regulators may wish to consider the proposed recommendations in the development of their regulatory frameworks or, where these already exist, in the supervision of their supervised entities. Finally, depending on the above, regulators may wish to consider whether their existing regulatory regimes are sufficient for oversight, and, where appropriate, clarify or expand their existing regulatory regime where any additional regulatory authority might be necessary or helpful.

## **5.1 Proposed Recommendations for IOSCO and IOSCO Members concerning ESG ratings and data products**

Where regulators have supervisory authority over ESG ratings and data products providers, they may wish to consider whether the reliability, comparability and interpretability of ESG ratings and data products could be enhanced by taking steps to improve the governance and transparency of the assessment process and the management of conflicts of interest. Taking steps to improve the governance, transparency and management of conflicts of interest

surrounding these products could in turn contribute to a greater level of confidence in the use of these products within the financial system, supporting a greater up-take in usage while simultaneously protecting investors and ensuring that markets are fair and efficient, in line with IOSCO objectives.

Where regulators have supervisory authority over Credit Rating Agencies (CRAs) that also issue ESG ratings and data products, they may wish to consider the extent to which the processes for determining ESG ratings and data products overlap with the processes for determining credit ratings. They may wish to consider whether there exists the potential for conflicts of interest between a CRA's credit rating offerings and its ESG ratings or data product offerings, and if so, the steps to consider to mitigate and address those conflicts of interest.

**Recommendation 1:** Regulators may wish to consider focusing more attention on the use of ESG ratings and data products and ESG ratings and data products providers in their jurisdictions.

*Please provide your views on the following action points related to this proposed recommendation. For example, would the action points outlined below help enable securities regulators to meet the objectives of this proposed recommendation? If so, how? Are there other action steps regulators may wish to consider?*

- Regulators may wish to consider their existing regulatory regimes and consider whether they provide sufficient oversight of ESG ratings and data products.
- Where regulators have supervisory authority over ESG ratings and data products providers, they may wish to consider:
  - Potential conflicts of interest that may occur with ESG ratings and data product offerings and other business relationships with the covered entities such as provision of second party opinions for green finance products and ESG consulting services, and whether the corporate governance organisational and operational structures of the provider are sufficient to identify, manage and mitigate any conflicts of interest?
  - Whether the data and information sources that the provider relies on are publicly disclosed, including the use of industry averages, estimations or other methodologies when actual data is not available or not publicly disclosed?
  - Whether the provider's methodologies are publicly disclosed, including whether and how the methodologies are defining the individual components Environmental, Social, Governance of "ESG", including the specific issues being assessed, the KPIs used and measurement methodologies underlying each KPI?
  - Whether the provider's ESG ratings and data products are issued consistent with the relevant methodologies?
  - Whether the processes underlying ESG ratings and data products are subject to written policies and procedures and/or internal controls to ensure they are rigorous, systematic, and applied in a continuous manner?



- Regulators may wish to consider whether there are opportunities to encourage industry participants to develop and follow common industry standards or codes of conduct, and what role IOSCO could play in supporting the development of such standards or codes, regarding:
  - the identification, management and mitigation of conflicts of interest for ESG ratings and data products providers;
  - consistency and transparency of ESG ratings and data product methodologies; and/or
  - the use of sustainability related and ESG rating and data product terminology to help improve consistency in the use of these terms in the ESG rating and data products providers' industry.

## 5.2 Proposed Recommendations for ESG ratings and data products providers

For ESG ratings and data products providers, IOSCO has received feedback that there is scope for guidance to improve the reliability, comparability, and interpretability of ESG ratings and data products.

To help address the issues that have been raised, IOSCO has proposed recommendations regarding transparency and consistency in the application of the rating and assessment process, the identification, management, and mitigation of conflicts of interest, transparency of data sources, and disclosures and handling of confidential information. The goal here is to propose high level guidance for ESG ratings and data products providers that is sufficiently flexible to accommodate the developing nature of this market.

**Recommendation 2:** ESG ratings and data products providers could consider issuing high quality ESG ratings and data products based on publicly disclosed data sources where possible and other information sources where necessary, using transparent and defined methodologies.

*Please provide your views on the following action points related to this proposed recommendation. Would the action points outlined below help enable ESG rating and data products providers to meet the objectives of this proposed recommendation? If so, how? Are there other action steps ESG rating and data products providers could consider?*

- ESG ratings and data products providers may wish to consider:
  - adopting and implementing written procedures designed to ensure that the ESG ratings and data products they issue are based on a fair and thorough analysis of all relevant information available to them.
  - adopting, implementing and providing transparency around methodologies for their ESG ratings and data products that are rigorous, systematic, applied continuously and, for ESG ratings, subject to some form of validation based on historical experience, where available.
  - ensuring these methodologies are subject to regular review, with sufficient communication regarding changes made to the methodologies as well as potential

impacts of these changes to the ESG ratings and data products.

- providing transparency around the sources of data used in determining their ESG ratings and data products, including the use of any industry averages, estimations or other methodologies when actual data is not available. This may include transparency around whether the data used is up to date, publicly sourced or proprietary in nature, including through approximations.
- monitoring on an ongoing basis, and regularly updating, their ESG ratings and data products.
- maintaining internal records to support their ESG ratings and data products.
- sufficient resources to carry out high-quality ESG-related assessments, including sufficient personnel and technological capabilities, to seek out information they need in order to make an assessment, and analyse all the information relevant to their decision-making processes.
- how to ensure personnel involved in the deliberation–of ESG ratings and data products are professional, competent, and of high integrity.

**Recommendation 3:** ESG ratings and data products providers could consider ensuring their decisions are, to the best of their knowledge, independent and free from political or economic pressures and from conflicts of interest arising due to the ESG ratings and data products providers’ organizational structure, business or financial activities, or the financial interests of the ESG ratings and ESG data products providers’ employees.

**Recommendation 4:** ESG ratings and data products providers could consider, on a best efforts basis, avoiding activities, procedures or relationships that may compromise or appear to compromise the independence and objectivity of the ESG rating and ESG data products provider’s operations or identifying, managing and mitigating the activities that may lead to those compromises.

*Please provide your views on the following action points related to these proposed recommendations. Would the action points outlined below help enable ESG rating and data products providers to meet the objectives of these proposed recommendations? If so, how? Are there other action steps ESG rating and data products providers could consider?*

- ESG ratings and data products providers may wish to consider:
  - adopting written internal procedures and mechanisms to (1) identify, and (2) eliminate, or manage, mitigate and disclose, as appropriate, any actual or potential conflicts of interest related to their ESG ratings or data products that may influence the opinions and analyses ESG ratings and data products providers make or the judgment and analyses of the individuals they employ who have an influence on their ESG ratings or data product decisions. ESG ratings and data products providers should aim to disclose such conflict avoidance and management measures.
  - taking steps to ensure the ESG ratings and data products products would not be

affected by the existence of or potential for a business relationship between the ESG ratings and data products providers (or their affiliates) and any company or any other party for which it provides ESG ratings or data products.

- putting in place measures to ensure their staff members refrain from any securities or derivatives trading presenting inherent conflicts of interest with the ESG ratings and data products.
- structuring reporting lines for their staff and their compensation arrangements to eliminate or effectively manage actual and potential conflicts of interest related to their ESG ratings and data products.
- not compensating or evaluating staff on the basis of the amount of revenue that an ESG rating and data products provider derives from a company that staff provides ESG ratings and data products for, or with which staff regularly interacts regarding such ESG ratings and data products.
- disclosing the nature of the compensation arrangement or any other business or financial relationships that exist with a company for which the ESG ratings and data products provider provides ESG ratings or data products.

**Recommendation 5:** ESG ratings and data products providers could consider making high levels of public disclosure and transparency an objective in their ESG ratings and data products, including their methodologies and processes.

*Please provide your views on the following action points related to this proposed recommendation. Would the action points outlined below help enable ESG rating and data products providers to meet the objectives of this proposed recommendation? If so, how? Are there other action steps ESG rating and data products providers could consider?*

- ESG ratings and data products providers may wish to consider:
  - making high levels of public disclosure and transparency an objective in their ESG ratings and data products.
  - ensuring their ESG ratings and data products are clearly labelled to enable the user to understand the ESG rating's or ESG data product's intended purpose including its measurement objective.
  - publicly disclosing the data and information sources they rely on in offering ESG ratings and data products, including the use of industry averages, estimations or other methodologies when actual data is not available.
  - publishing sufficient information about the procedures and methodologies underlying their ESG ratings and data products to enable the users of these products to understand how their outputs were determined.
- Information regarding methodologies that ESG ratings and data products providers may wish to consider publishing include, but is not limited to:

- the measurement objective of the ESG rating or data product;
- the criteria used to assess the entity or company;
- the key performance indicators used to assess the entity against each criterion
- the relative weighting of these criteria to that assessment;
- the scope of business activities and group entities included in the assessment;
- the principal sources of qualitative and quantitative information used in the assessment as well as information on how the absence of information was treated;
- the time horizon of the assessment; and
- the meaning of each assessment category (where applicable).

**Recommendation 6:** ESG ratings and data products providers could consider maintaining in confidence all non-public information communicated to them by any company, or its agents, related to their ESG ratings and data products, in a manner appropriate in the circumstances.

*Please provide your views on the following action points related to this proposed recommendation. Would the action points outlined below help enable ESG rating and data products providers to meet the objectives of this proposed recommendation? If so, how? Are there other action steps ESG rating and data products providers could consider?*

- ESG ratings and data products providers could consider :
  - adopting procedures and mechanisms related to their ESG ratings and data products to protect the non-public nature of information shared with them by companies under the terms of a confidentiality agreement or otherwise under a mutual understanding that the information is shared confidentially.
  - using non-public information only for purposes related to their ESG ratings and data products or otherwise in accordance with their confidentiality arrangements with the company.

### 5.3 Proposed Recommendation for users of ESG ratings and data products

For the users and uses of ESG ratings and data products, IOSCO has been able to draw on the process of its fact-finding exercise. The fact-finding exercise showed that ESG ratings and data products may underpin many ESG indices, and screening criteria for certain ESG-oriented products. IOSCO has identified that it would be beneficial to propose recommendations that promote the adoption of procedures for the conduct of due diligence and governance to ensure mechanistic reliance on ESG ratings and data products is avoided where at all possible.

**Recommendation 7:** Financial market participants could consider conducting due diligence on the ESG ratings and data products that they use in their internal processes. This due diligence could include an understanding of what is being rated or assessed by the product, how it is being rated or assessed and, limitations and the purposes for which the product is being used.

*Please provide your views on the following action points related to this proposed recommendation. Would the action points outlined below further the objectives of this proposed recommendation? If so, how? Are there other action steps financial market participants could consider?*

- Financial market participants may wish to consider evaluating the published methodologies of any ESG ratings or data products that they refer to in their internal processes. This evaluation could cover:
  - the sources of information used in the product, the timeliness of this information, whether any gaps in information are filled using estimates, and if so, the methods used for arriving at these estimates;
  - An evaluation of the criteria utilised in the ESG assessment process, the relative weighting of these criteria in the process, the extent of qualitative judgement and whether the covered entity was involved in the assessment process; and
  - a determination as to the internal processes of the financial market participant for which the product is suitable.

#### 5.4 Proposed Recommendation on how ESG ratings and data products providers may wish to consider interacting with entities subject to assessment

For the entities covered by ESG ratings and data products, IOSCO has drawn on feedback received during the fact-finding exercise to propose recommendations these providers could consider to help address some of the reported shortcomings in market conduct.

**Recommendation 8:** ESG ratings and data products providers could consider improving information gathering processes with entities covered by their products in a manner that is efficient and leads to more effective outcomes for both the providers and these entities.

**Recommendation 9:** ESG ratings and data products providers could consider responding to and addressing issues flagged by entities covered by their ESG ratings and data products while maintaining the objectivity of these products.

*Please provide your views on the following action points related to this proposed recommendation. Would the action points outlined below help enable ESG rating and data providers to meet the objectives of this proposed recommendation? If so, how? Are there other action steps ESG rating and data products providers could consider?*

- Where they collect information from covered entities on a bilateral basis, ESG ratings and data products providers may wish to consider:
  - communicating sufficiently in advance when they expect to request this information regarding their ESG ratings and data products.
  - including in their requests, pre-inputted information either from publicly available sources or from the covered entities previous submissions, where possible, for the covered entities' review or confirmation.
- ESG ratings and data products providers may wish to consider:
  - providing a clear and consistent contact point with whom the covered entity can interact to address any queries relating to the assessment provided by the ESG ratings and data products provider.

- informing covered entities of the principal grounds on which an ESG rating or ESG data product is based before the publication of the ESG rating or data product.
- allowing the covered entity time to draw attention to any factual errors in the product, including the data and information underlying the product.

## 5.5 Proposed Recommendation on how covered entities could consider interacting with ESG ratings and data products providers

The final part of IOSCO’s proposed recommendations addresses those entities covered by ESG ratings and data products providers. This element is included with the intention to address the full spectrum of issues relevant to the production of ESG ratings and data products. For the entities covered by these products, IOSCO proposes recommending that they consider disclosing information in a manner that is consistent, predictable and easy to access. In this regard, some practical steps that could be considered might include ensuring that sustainability information is made public and is consolidated in the minimum number of locations, with maximum visibility over previous and upcoming disclosures. These steps may help provide ESG ratings and data products providers with the information they need to carry out up to date and accurate assessments, which might reduce the burden on covered entities to follow up with providers to discuss any errors or omissions.<sup>22</sup>

**Recommendation 10:** Entities subject to assessment by ESG ratings and data products providers could consider streamlining their disclosure processes for sustainability related information to the extent possible, bearing in mind regulatory and other legal requirements in their jurisdictions.

*Please provide your views on the following action points related to this proposed recommendation. Would the action points outlined below further the objectives of this proposed recommendation? If so, how? Are there other action steps entities subject to assessment by ESG rating and data products providers could consider?*

- Entities subject to assessment by ESG ratings and data products providers may wish to consider:
  - creating a dedicated section of their website, or a corporate publication, that includes links to, or coordinates for, all the entities’ sustainability related publications.
  - including, in the information provided on the dedicated section of their website or corporate publication, the dates of the relevant publications, as well as the timelines for which they are expected to be updated or refreshed.
  - designating a dedicated internal point of contact to address any requests from or queries to ESG ratings and data products providers that provide coverage for that entity.

<sup>22</sup> The STF Workstream 1 report can be accessed at the following link:  
<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD678.pdf>

## Glossary

In developing an overview of the market for ESG ratings and data products a common frame of reference is beneficial. In this regard, a common understanding of what “ESG ratings” and “ESG data products” refer to is called for, as different studies have looked at different markets, referring to broad terminologies such as ESG data products and ESG ratings.

Following feedback by respondents during its fact-finding exercise, IOSCO has refined these terms as per the box below. The terms used in this Report should therefore be understood as per the definitions within the box.

<b>Scoping Terminology – ESG Data Products and ESG Ratings</b>
<p><i>“ESG data products”</i>: refer to the broad spectrum of data, including raw data where appropriate, and related products in the sustainable finance area that are marketed as providing information on an entity, a financial instrument or a product, a company or an industries’ ESG profile, characteristics or exposure to ESG, climatic or environmental risks whether or not they are explicitly labelled as “ESG data products”.</p>
<p><i>“ESG ratings”</i>: refer to the broad spectrum of ratings and related products in the sustainable finance area that are marketed as providing an assessment of an entity, a financial instrument or a product, a company ESG profile, or characteristics or exposure to ESG, climatic or environmental risks, whether or not these are explicitly labelled as “ESG ratings”.</p>

In addition to assessing whether there is a common terminology for the products that are offered in this market, IOSCO has sought to understand if there is a common understanding of the attributes that these products are intended to measure.

The starting point was to assess whether there is a common understanding of the terms “ESG factors” and “ESG risks” among market participants and, in this context, what it meant from an investment decision-making perspective. Respondents suggested that there is no such common understanding in the market, that is, no systematic and consistent approach to assess risk stemming from ESG factors. As such, what these terms mean from an investment decision-making perspective varied by geographical regions or areas of specialisation.

In the absence of a common understanding of the meaning or relevance of these terms amongst market participants, IOSCO sought to explore whether market participants had developed their own internal working definition of ESG. Responses to this question proved inconclusive. While some respondents indicated that they had set certain investment objectives relating to ESG or sustainability performance of business models, very few respondents indicated that they had developed an internal working definition of the term “ESG risks or factors” and were unable to set out what they would consider to be a good ESG profile from an investment perspective. In conclusion, the practices amongst the users of ESG ratings and data products seem to mirror the practices of the providers, with individual views being set according to specific investment or measurement objectives and different expectations on sustainability practices.

<b>Comments Provided by Stakeholders During IOSCO Fact-Finding Exercise</b>
<p><b>Term “ESG” has been defined by some market participants, although this was a minority of cases.</b></p>
<p><i>For us, ESG means a systemic risk which would be critical to our long-term return. In the short-term, it is difficult to clearly identify it. But, as our investment time horizon goes beyond the short-term, it would be more likely that ESG factors impact us directly or indirectly. We do ESG to maximise our risk adjusted return.</i></p>

**Other more ad-hoc judgements for “ESG” in place where this is not present.**

*While we have not developed a definition for ESG, we have defined what sustainability means to our company to ensure we had a common understanding and to guide forward progress:*

*Sustainability is embedded in the way we do business. It means creating a safe and inclusive workplace, partnering with local and Indigenous communities, and innovating to minimize our impact on the environment. We believe striking the right balance among environmental, economic and social considerations creates long-term, sustainable value.*

Beyond these key terms, other important sustainability-related terms may be used within the Report. IOSCO has defined them as follows:

- Greenwashing refers to the practice by asset managers of misrepresenting their own sustainability-related practices or the sustainability-related features of their investment products
- IFRS Foundation refers to International Financial Reporting Standards Foundation. A not-for-profit, public interest organization established to develop a single set of high-quality, understandable, enforceable and globally accepted accounting standards—IFRS Standards—and to promote and facilitate adoption of the standards. IFRS Standards are set by the IFRS Foundation’s standard-setting body, the IASB.
- ISSB refers to International Sustainability Standards Board. An independent group of experts with an appropriate mix of recent practical experience in setting accounting standards, in preparing, auditing, or using financial reports, and in accounting education. Broad geographical diversity is also required. Board members are responsible for the development and publication of IFRS Standards, including the IFRS for SMEs Standard. The Board is also responsible for approving Interpretations of IFRS Standards as developed by the IFRS Interpretations Committee (formerly IFRIC). Members are appointed by the Trustees of the IFRS Foundation through an open and rigorous process that includes advertising vacancies and consulting relevant organisations.
- “Sustainability” refers to meeting the needs of the present without compromising the ability of future generations to meet their needs. In that regard, it covers ESG factors.



## Annex 1: IOSCO Sustainability Task Force WS3 Questionnaire

### 1. General Questions (for all except ESG rating and data providers)

- 1.1 Please provide details of your **views on ESG ratings** from a general perspective. *In providing your answer, please outline your experiences of using and integrating ESG ratings within your internal processes, your interactions with ESG ratings providers and the aspects of these products you find most useful as well as those that cause the most difficulty.*
- 1.2 Please provide your **views on ESG data** from a general perspective. *In providing your answer, please outline your experiences around ESG data and integrating ESG data products within your internal processes, your interactions with ESG data providers and the aspects of these products you find most useful and those that cause the most difficulty.*
- 1.3 Has your institution developed its own definition of the term “ESG” for the purpose of its investment or financing decisions? If yes, *please provide this definition and describe the objectives that your institution aims to achieve through the term.*
- 1.4 Does your institution follow or comply with any ESG related standards in its investment or public disclosure activities?
- 1.5 Please provide your views as to whether IOSCO has a role to play in the area of ESG ratings and ESG data providers and, if so, what you consider that role might be.

#### *ESG Rating Products*

- 1.6 What ESG rating products do you use in your internal processes? *In providing your response, please provide details of the different ESG rating products that you currently refer to including their product name, product description and provider name.*
- 1.7 What aspects of an issuer or entity’s profile does your institution use ESG ratings products to assess?
- 1.8 Do you use ESG rating products from more than one ESG rating provider? *If yes, please provide the reasons for this. For example, is it to increase coverage of the investment universe, to provide an alternative assessment? If you do not use products from more than one provider, please outline the reasons for this decision.*
- 1.9 Have you encountered any issues using ESG ratings from different providers to assess the aspects of an issuer or entity’ profile? *If yes, please describe the nature of these issues and the steps, if any, that you take to resolve these issues.*

#### *ESG Data Products*

- 1.10 What ESG data products do you use in your internal processes? *In providing your response, please provide details of the different ESG data products that you currently refer to including their product name, product description and provider name.*
- 1.11 What aspects of an issuer or entity’s profile that your institution uses ESG data products to assess?
- 1.12 Do you use ESG data products from more than one ESG data provider? *If yes, please outline whether this is to increase coverage of the investment universe or to provide an alternative*

*assessment. If you do not use products from more than one provider, please outline the reasons for this decision.*

- 1.13 Have you encountered any issues using ESG data products from different providers for your internal purposes? *If yes, please describe the nature of these issues and the steps, if any, that you take to resolve these issues.*

#### *Development of ESG Industry*

- 1.14 Do you consider the variations between the ESG rating products that are currently available in the market to be a positive or a negative feature of the market? *In providing your answer, please outline what steps you consider should be taken to enhance or correct this feature of the market. If possible, please support your answer with reference to the specific practices of ESG rating and data providers that should be addressed.*
- 1.15 Should any activities of ESG rating and ESG data providers be subject to regulation or regulatory oversight? *In providing your answer, please refer to the categorization of their activities in 4.21 or 4.26 and describe the specific activities of these providers that you consider to be in a greater or lesser degree in need of regulation or oversight, and the reasons supporting this position.*

## **2. Specific Questions for Private and Public Sector Users of ESG Ratings and Data**

### *Mandate and General Use*

- 2.1 What is the nature of your institutions' mandate or business model? *For example, please outline whether your institutions' mandate or business model relates to public, proprietary or client investment, a combination of these, or other purpose.*
- 2.2 For what elements of this mandate do you refer to ESG ratings?
- 2.3 For what elements of this mandate do you refer to ESG data?
- 2.4 Please describe from a general perspective how **ESG ratings** have been incorporated into your institutions' proprietary investment decisions, counterparty risk assessments, client investment mandates, construction of product offerings, or capital raising purposes? *In providing your answer, please provide a description of each purpose and the role ESG ratings perform.*
- 2.5 Please describe from a general perspective how **ESG data products** have been incorporated into your institutions' proprietary investment decisions, counterparty risk assessments, client investment mandates, construction of product offerings, or capital raising purposes? *In providing your answer, please provide a description of each purpose and the role ESG data products perform.*
- 2.6 Does your institution produce internal ESG ratings according to an in-house methodology? *If yes please provide details on the reasons for adopting this approach and, if possible, provide details of the measurement objectives of these ratings.*
- 2.7 If your institution produces internal ESG ratings according to an in-house methodology, do you benchmark your ratings against external rating providers? *If yes, please outline some of the challenges you encounter in this process.*

*Consumption of ESG rating ESG data products*

- 2.8 Do you contract with **ESG rating providers** for ESG ratings data? If yes, how many ESG rating providers do you contract with? If no, by what means do you receive ESG ratings data?
- 2.9 Do you contract with any **ESG data providers** for ESG data? If yes, how many ESG data providers do you contract with? If no, how do you receive ESG data?
- 2.10 If you answered yes to 2.4 **and** 2.5, are these the same providers for ESG ratings and ESG data? Do you use more than one provider for each? If so, please explain why.
- 2.11 To what extent have you developed or are your developing in house capabilities to reduce reliance on externally provided ESG ratings and ESG data?

*Due Diligence or Verification of ESG rating and ESG data products*

- 2.12 Do you conduct due diligence or verification of the **ESG ratings** that you use in the internal processes? If yes, what is the nature of this due diligence or verification? *In providing your answer, please outline which elements of ESG ratings pose the greatest difficulties for conducting this due diligence or verification? Do you refer to complimentary data sources to provide a second opinion? If yes, what are these complimentary data sources? If not, please provide the rationale for not conducting due diligence or verification of the ESG ratings used in your internal processes.*
- 2.13 Do you conduct due diligence or verification of the **ESG data** you use in the internal processes? If yes, what is the nature of this due diligence or verification? *In providing your answer, please outline the elements of ESG data that pose the greatest difficulties for due diligence or verification and whether you refer to complimentary data sources to provide a second opinion? If yes, what are these complimentary data sources? If not, please provide the rationale for not conducting due diligence or verification of the ESG data used in your internal processes.*
- 2.14 Have you identified any situation of potential conflicts of interest for ESG ratings and ESG data providers? *If yes, please specify.*
- 2.15 Have you identified any good practices of ESG ratings and ESG data providers to prevent conflict of interest or enhance the transparency of their products or business itself? *If yes, please specify.*

**3. Specific Questions for issuers subject to ESG ratings and ESG data collection**

- 3.1. Please describe from a general perspective your current level of interaction with those companies providing ESG rating and data products on your company. *In providing your answer, please describe the aspects of these interactions you are most and least satisfied with.*
- 3.2. Do you have any interactions with companies that are providing ESG rating assessments on your company on an 'investor paid' basis? *If yes, at what point(s) in the rating process (data collection, data assessment, or pre-publication) do these interactions with the ESG rating provider occur?*
- 3.3. If multiple ESG rating providers provide ESG ratings on your company on an investor paid basis, to what extent do the different approaches of each rating provider create difficulties for your internal processes? *For example, variations in timing of information requests, differences in information assessed, or other.*

- 3.4. If ESG ratings are provided on your company on an “investor paid” basis, are you provided with these ratings by the ESG rating providers? If yes, are you provided with access to your rating for free?
- 3.5. Has your company contracted with an ESG rating provider for an ESG rating on an “issuer pays” basis? *If yes, for what reason(s) has your company contracted for an ESG rating.*
- 3.6. For those ESG ratings and data products that refer to your company, are you offered the opportunity to correct any material error relating to your company that you would have identified? Can this occur before or after publication?
- 3.7. Do you consider that the ESG data that is used by ESG rating providers or data providers about your company is accurate and up to date? *Please provide the reasons supporting your answer.*
- 3.8. Have you identified any situations or aspects of the business models that may give rise to potential conflicts of interest for ESG ratings and ESG data providers? *If yes, please specify.*
- 3.9. Do you contract with any ESG rating or data provider for ESG ratings, ESG data products or other services? *If yes, what are these services?*
- 3.10. Have you identified any good practice to prevent conflict of interest for ESG ratings and ESG data providers or enhance transparency of their products or business itself? *If yes, please specify.*
- 3.11. What steps in your view would be most helpful to reduce the reporting burden of issuers subject to ESG ratings and ESG data collection while ensuring the availability of high-quality information?
- 3.12. Can you provide an example of good practices from ESG rating and data providers that resulted in a more streamlined collection of information on your company?

#### **4. Specific Questions for ESG Rating and data Providers**

##### *Product Offerings – General*

- 4.1 Please provide an overview of the different ESG rating and ESG data products that you currently offer to your clients. *In providing your answer, please list each of the different ESG rating products and ESG data products that a client may contract with your company to receive. Alongside each product, please outline the purpose/assessment it is intended to provide such as whether they look to assess or reward the transition of business models.*
- 4.2 Which aspects of an issuer or entities’ profile do you consider your ESG rating products are most suitable for assessing? *If you provide multiple rating products, please list these alongside the aspects they are most suitable for assessing.*
- 4.3 Please describe the principal difficulties that you encounter with issuer or entities’ public disclosure practices? *For example, please explain whether and how the timing of entity level disclosures has an impact on ensuring the ESG ratings and data you provide are accurate and up to date.*
- 4.4 Please provide examples of good practices that could be adopted by issuers or entities in their interactions with ESG rating and data providers to ensure their ratings and data is accurate and up to date.
- 4.5 If your ESG rating and data provider uses bilateral questionnaires to receive information from rated entities, please describe the process by which this information is collected?

- 4.6 If you answered yes to **4.5**, do you consider it feasible from an internal perspective to provide issuers with a pre-filled questionnaire on which the issuer could confirm or correct certain information.

*ESG Rating products*

- 4.7 How many companies do you cover with your ESG rating products?
- 4.8 What is the general level of coverage of publicly listed companies by major geographic region?
- 4.9 What is the extent of your coverage of private unlisted companies in these regions? *If there are significant differences between coverage of publicly listed and private companies, please elaborate on the reasons for this difference.*
- 4.10 Are your ESG ratings subject to a minimum frequency of review? *If yes, please outline the frequency and the factors that may lead to an increase or decrease in the frequency of review.*
- 4.11 Do you consider that ESG rating methodologies should be sector specific, or do you consider that they should be business-model agnostic and capable of being applied across multiple industry and rated entity categories? In providing your answer, please outline the factors in favour of your position.

*ESG data products*

- 4.12 What are the five most common ESG data products used by your clients on a global level.
- 4.13 Do you see regional variations in the popularity of these five most common ESG data products? *In providing your answer, please outline which products are more commonly used according to geographic region and the reasons you consider this to be the case.*

*Other Products*

- 4.14 Beyond your ESG ratings and ESG data products, do you offer other ESG related products or services to investors or issuers? *For example, consultancy or advisory services. Have you identified any potential conflicts of interests arising from the universe of ESG ratings or ESG data products and services that you provide? How do you manage these?*

*Business Model*

- 4.15 With regards to your ESG rating products, please could you explain your fee model?
- 4.16 Please provide a high-level breakdown of the ratio on which these ESG rating products are provided on an issuer pays or investor pays basis.
- 4.17 Has there been any shift in the extent to which these products are provided on an issuer pays or investor pays basis over the last three years?
- 4.18 Please outline whether and to what extent the ESG data products that you provide are publicly available.
- 4.19 Please outline whether and to what extent these ESG rating products are made publicly available.

*Methods used in the Industry*

4.20 What types of interactions do you have with rated entities and at what time of your rating process do they occur? *Does the manner and frequency of these interactions differ for those ratings that are provided on an investor pays basis?*

4.21 On a scale of 1 – 5, with 1 being not at all beneficial and 5 being very beneficial. Do you think the harmonisation of standards for ESG ratings would be beneficial in the following areas? *Please explain your answers.*

i. The methodologies underlying ESG ratings (including what they seek to measure);

1	2	3	4	5

ii. The disclosures applicable to ESG rating methodologies;

1	2	3	4	5

iii. The disclosures applicable to ESG ratings themselves;

1	2	3	4	5

iv. The conflict of interest arrangements within ESG rating providers;

1	2	3	4	5

v. The supervision of ESG rating products.

1	2	3	4	5

4.22 With regards to your ESG rating or ESG data products, to what extent are these produced using technological tools such as Artificial Intelligence, or Machine Learning? *In providing your answer, please outline what you consider to be the advantages or disadvantages of these tools in producing your ESG rating or data products.*

4.23 With regards to your ESG ratings analysis, do you conduct any due diligence on the ESG related information that is used within your rating processes. *If yes, how do you perform this due diligence?*

4.24 To what extent do you assess your ESG ratings performance against those of other ESG rating providers?

*Regulatory or Voluntary Frameworks*

4.25 Are there any regulatory or supervisory expectations placed on you at the national level, in relation to the provision of your ESG ratings and/or ESG data? *Please describe.*

4.26 Do you adhere to any regulatory or voluntary frameworks in the following areas? *If yes, please outline the regulatory or voluntary framework.*

i. The methodologies underlying the ESG ratings (including what they seek to measure);

ii. The disclosures applicable to ESG rating methodologies;

- iii. The disclosures applicable to ESG ratings themselves;
- iv. The conflict of interest arrangements within ESG rating providers;
- v. The supervision of ESG rating products.

4.27 Please provide your views on whether/how IOSCO could play a useful role in the area of ESG ratings and ESG data providers.

## Annex 2: Overview of ESG Rating and Data Products Providers

Overview of ESG Rating and Data Products Providers					
Name of Entity	Date of Establishment	Location of Headquarters	Presence in Geographic Regions	Overview of Business Lines	Website
XYZ	[DD/MM/YYYY]	[COUNTRY NAME]	[EMEA/AMER/APAC]	[100 WORD LIMIT]	[Link]