

CONSULTATION RESPONSE

IOSCO CONSULTATION REPORT ON ESG RATINGS AND DATA PRODUCTS PROVIDERS

6 September 2021

INTRODUCTION

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI is now a not-for-profit company with over 4,000 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles with approximately US \$121 trillion in assets under management.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

The PRI welcomes the opportunity to respond to the consultation report on ESG ratings and data products providers, published by the Board of the International Organization of Securities Commissions (IOSCO).

ABOUT THIS CONSULTATION

On 26 July 2021, the Board of IOSCO published a [Consultation Report](#) with the aim of assisting IOSCO members in understanding the implications of the activities of "ESG ratings and data products providers". This term is explained to include ESG ratings providers, ESG data products providers, as well as providers who offer both ESG ratings and data products.

According to IOSCO, 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. IOSCO is inviting stakeholders to comment on the recommendations set out in the report.

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KEY RECOMMENDATIONS

The PRI welcomes increased attention by regulators to the market for ESG ratings and data products and the providers of these products, given the important role these products play in investment processes. The market for ESG data and ratings has experienced considerable growth and consolidation in recent years. Demand for these products and services is only likely to keep growing in the future as investors increasingly face mandatory ESG disclosure requirements¹.

In light of these developments, supervisory authorities should consider regulatory action to enhance the functioning of the market for ESG ratings and data products. The PRI recommends that regulators focus their attention on:

- Improving transparency by ESG ratings and data products providers on their methodologies and processes, by developing minimum quality and transparency standards.
- Ensuring that ESG ratings and data products providers have appropriate governance arrangements in place and that offered products and services are free of conflict of interest or other undue influences (with greater clarity on whether and how the rated issuer perspective is included into the rating and engaged by the provider).

In addition, we recommend accelerating the reforms towards mandating corporate reporting standards and disclosures of key underlying ESG data. We welcome global and regional efforts by regulators to improve the reliability, consistency, and comparability of corporate ESG reporting standards and disclosures. These efforts are crucial to increase the availability and quality of ESG data, and by extension the quality of ESG ratings and data products.

The PRI acknowledges that investors have the responsibility to understand the intended purposes and the methodologies of ESG ratings and data products and should determine whether these are suitable for the purpose for which they are being used in the investment process.

DETAILED RESPONSE

IOSCO 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.

PRI response

The PRI suggests reformulating this recommendation to the following:

“Regulators should include the use of ESG ratings and data products, and ESG ratings and data products providers, in their core regulatory and supervision responsibilities.”

The PRI supports increased attention by regulators to the market for ESG ratings and data products and the providers of these products. The strong growth of responsible investment practices has led to

¹ According to a recent position paper by the [AFM and AMF](#), the ESG data and services market could reach a value of over US\$5 billion by 2025 (Position Paper: Call for a European Regulation for the provision of ESG data, ratings, and related services).

a steep increase in the demand for ESG data and related products and services. Almost all investors now use third party providers for obtaining at least some of their ESG data and analysis, and some investors even predominantly rely on externally processed data and other resources like ESG scores.² Although large investors are increasingly developing in-house metrics to better capture ESG risks and opportunities and sustainability performance within their investment processes, third-party providers will likely continue to play an important role by providing more tailored services, such as modelling and analytics, and bespoke data feeds. As intermediaries between corporates and investors, they are an essential component of the sustainable investment chain.

Given that ESG ratings and data products play such an important role in investment decision-making, it is paramount that these products are reliable, high quality and transparent. Consequently, supervisors should develop mandatory regulatory requirements (as part of a wider sustainable finance policy framework³) that focus on addressing the following issues:

- **Transparency on methodologies:** Especially for those investors that continue to rely on the ESG ratings and data products provided by external providers, improved transparency is critical. If the underlying methodologies of the products are well explained and communicated, investors can choose the offerings that best meet their investment processes. For example, some ESG ratings try to capture an issuer's exposure to ESG risks and how prepared they are to manage these risks – how ESG ratings providers make such assessments should be better explained. This should also help the market better understand the reasons behind divergent ESG ratings from different providers.
- **Governance and conflicts of interest:** To ensure the reliability of ESG ratings and data products, providers of these products should have adequate governance arrangements in place to identify, manage and mitigate any potential conflicts of interests that may occur as a result of the organisational structure of the provider, fee structures or intersecting business activities. Especially for ESG ratings, investors need to have assurance that an evaluation of a given company was not unduly influenced, for example due to the fee model ('issuer pays') or consulting services provided to that company by the same provider.

Regulators should also consider transparency requirements on **pricing policies**, given the recent market consolidation in the ESG rating and data sector.

Regulatory requirements should be **proportional** and allow for market innovation when it comes to rating methodologies, without interfering with the methodologies themselves. They could also draw on past and existing voluntary standards for responsible investment research, such as ARISTA⁴.

The **availability of reliable and high-quality ESG data** is also a critical component of ESG ratings and data products and determines to a large extent the quality of the products. Therefore, the lack of reliable, consistent, and comparable ESG reporting standards and disclosures from issuers impacts

² See for example p.3 of the results from a PRI survey for fixed income investors on ESG information providers: <https://www.unpri.org/credit-risk-and-ratings/broadening-the-outreach-to-esg-information-providers/6210.article>

³ PRI, World Bank: How policy makers can implement reforms for a sustainable financial system (2020) : <https://www.unpri.org/policy/regulation-database/policy-and-regulation-toolkit>

⁴ ARISTA is the Responsible Investment Research Standard, developed in response to the demands from global investors and companies for responsible investment (RI) research groups to incorporate the key principles of quality, integrity, transparency and accountability into their research processes. https://vigeo-eiris.com/wp-content/uploads/2012/11/2012_Press_release_ARISTA_3_0.pdf

not only the availability and quality of information that can be used by investors, but also by ESG ratings and data products providers. Current global efforts - led by the IFRS Foundation (and supported by IOSCO) - to establish a global baseline for corporate sustainability reporting focussed on enterprise value creation and regional developments that introduce or expand corporate ESG standards and disclosure requirements, can help to address this issue, and are particularly welcome. Regulators should continue to support these processes and work to align standards and disclosure requirements for corporates where possible.

IOSCO 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.

PRI response

The PRI suggests reformulating this recommendation to the following:

“ESG ratings and data products providers should be required to issue quality controlled ESG ratings and data products, based on publicly disclosed data sources where possible, and other information sources where necessary, using transparent and defined methodologies.”

The PRI supports increased transparency on the data sourcing underpinning ESG ratings and data products. To enable investors to understand the underlying nature and basis of the ESG information - either in terms of the underlying data set and/or the methodology used to arrive at the evaluation or opinion - providers need to disclose and clearly signpost data sources, distinguishing between whether an issuer’s information is public (either voluntary or mandatory) or generated by internal models and assumptions, and whether those are AI or non-AI derived. In addition, investors need more information on how data is updated, for example when data sources are discontinued, or historical data is revised.

Furthermore, ESG ratings and data products providers should acknowledge that high quality ESG data is biased towards more-readily available information in the investment-grade and developed markets. Consequently, providers should consider, where possible, reducing data coverage gaps and biases by increasing and adapting the coverage of emerging markets and non-listed issuers (e.g. private and sovereign issuers) in their products, subject to full transparency on data sources and methodologies as advocated above.

IOSCO Recommendations 3 & 4

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.

ESG ratings and data products providers could consider, on a best effort 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.

PRI response

The PRI recommends reformulating the language used from “*could consider*” to “*should*”.

ESG ratings and data products providers – like other product and service providers in the financial markets – should ensure they have appropriate governance arrangements in place and that offered products and services are free of conflict of interest or other undue influences. This is particularly important for ESG ratings or scores (as well as rankings), where the interplay with other services offered by the same provider could create conflicts of interest (see our response to Recommendation 1).

To ensure reliability and quality of the services provided and proper management of potential conflicts of interests, specific governance requirements should go beyond a best effort basis and be elevated to mandatory requirements for ESG ratings and data products and their providers.

IOSCO 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.

PRI response

The PRI agrees with this recommendation and recommends reformulating the language to:

“ESG ratings and data product providers should ensure high levels of public disclosure and transparency of their ESG ratings and data products, including their methodologies and processes”.

As indicated in our response to Recommendation 1, the PRI agrees there is a need for improved transparency on the methodologies and processes for ESG ratings and data products. For investors to choose the product that best fits with their investment processes, they need to be able to understand the ESG rating's or ESG data product's intended purpose (including its measurement objective) and how its outputs were determined. In this context, investors have indicated that providers should particularly improve their communication in the event of changes to the data or methodology, for example by organising consultations or providing ad-hoc updates.⁵

In addition, improved transparency would not only help investors, but also make ESG ratings and data products providers more accountable for how they verify and validate their data sources and metrics, including to regulators. This in turn can help to increase the reliability and quality of ESG ratings and data products.

⁵ PRI research 'Do ESG information providers meet the needs of fixed income investors?'; <https://www.unpri.org/credit-risk-and-ratings/do-esg-information-providers-meet-the-needs-of-fixed-income-investors/8067.article?adredir=1>

IOSCO 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.

PRI response

No PRI response.

IOSCO 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.

PRI response

The PRI agrees that investors or other users of ESG ratings and data products should ensure they understand the intended purpose and methodology of the product, and to determine whether it is suitable for the purpose for which it is being used in the investment process. Ultimately, investors decide on what ESG information and analysis is incorporated in their investment decisions and therefore bear the responsibility to ensure that any ESG ratings or data products used in the investment process are fit for purpose. However, as indicated in our response to Recommendations 1,2 and 5, this is also contingent on increased transparency by ESG ratings and data product providers on the methodologies of their products to enable investors to conduct this due diligence in full.

IOSCO Recommendations 8 & 9

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.

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.

PRI response

No PRI response.

IOSCO 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.

PRI response

The PRI welcomes the recommendation to issuers to consolidate, publish and update their sustainability information in one dedicated location that is easily and digitally accessible. This would not only help ESG ratings and data products providers, but also make it easier for investors to obtain 'raw' ESG data directly from issuers. Nonetheless, it should be noted that these steps do not negate the need to address the lack of consistency and comparability of ESG information disclosed by issuers, as mentioned in our response to Recommendation 1.