September 13, 2021

Board of the International Organization of Securities Commissions
c/o Kris Nathanail-Brighton
International Organization of Securities Commissions
Calle Oquendo 12
28006 Madrid
Spain

By email: consultation-02-2021@iosco.org

Re: Public Comment on ESG Ratings and Data Products Providers

Dear Messrs. And Mesdames:

The Global Financial Markets Association (GFMA[1]) is pleased to submit this response to the July 2021 Environmental, Social and Governance Ratings and Data Products Providers Consultation Report (the "Report") published by the Board of the International Organization of Securities Commissions ("IOSCO").[2] We welcome the consideration of the issues regarding ESG ratings and data products discussed in the Consultation Report. As the Consultation Report notes, the use of ESG ratings and data products has grown considerably as investors' focus on ESG matters continues to increase and financial institutions face increasing sustainability disclosure requirements. We also note that in contrast to credit ratings, ESG ratings and data products are not generally subject to regulation. Please see our responses the IOSCO's recommendations below.

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[1] The GFMA represents the common interests of the world's leading financial and capital market participants, to provide a collective voice on matters that support global capital markets. We advocate on policies to address risks that have no borders, regional market developments that impact global capital markets, and policies that promote efficient cross-border capital flows, benefiting broader global economic growth. The Global Financial Markets Association ("GFMA") brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London, Brussels and Frankfurt, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA.

[2] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD681.pdf.

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.**

We welcome the fact-finding exercise conducted by IOSCO and share IOSCO's concerns related to the issues described in this consultation regarding a lack of transparency, comparability and reliability in the market of ESG ratings and data products. We support the proposed Recommendation 1 and the proposed action points outlined in the Consultation under this Recommendation. We encourage IOSCO to coordinate further work in this area to minimise fragmented approaches to this issue.

As noted in the Consultation, it is also vital to progress with the work under Workstream 1 to establish an international baseline for sustainability reporting standards through the International Sustainability Standards Board (ISSB). This work will help ensure greater availability of ESG data disclosed by companies which in turn will support improved quality of ESG ratings and data products. The introduction of requirements on financial services firms before data is widely available from corporates exacerbates the issues considered in the Consultation.

As discussed in the consultation, financial institutions currently face a number of challenges with respect to ESG ratings and data. Many of the issues around ratings stem from a lack of transparency around whether the rating is measuring ESG risk or sustainability impact, and we therefore propose that providers should specify the intended use of the rating. There is also insufficient transparency of methodologies, including on sources of information, calculation of ratings and an inability to replicate ratings, as well as with regard to the frequency with which ratings and underlying inputs are updated.

In addition, it must be kept in mind that different uses of ratings may require different policy approaches. For some use cases (e.g. as a tool for investment decisions) regulation may not be necessary and industry standards/best practices are best suited. For other uses, (e.g., counterparty risk assessment is more like credit ratings), regulation/guidance from regulators may be necessary.

It is very important that policymakers avoid regulatory fragmentation and help to ensure that providers of ESG ratings and data products provide transparency around the methodologies that they employ, as well as on what the data is intended to measure, and how it will be used. In this respect, we note that there are significant differences between the regulatory framework applicable to providers of ESG ratings and data products compared to, for example, those imposed on credit rating agencies under the EU CRA Regulation.

Any uncertainty or perceived unreliability caused by a lack of transparency on methodologies for ESG ratings or data, or insufficient transparency around why the ratings are different, or what they are measuring and being used for, will mean that market participants may not always have sufficient confidence in these external ESG ratings, and therefore may spend more effort than may be necessary to undertake their own internal assessments.

As stated below in response to Recommendation 2, market regulators, exchanges and accounting standards boards, in consultation with corporates, banking and capital markets firms, and investors, should continue to develop consistent climate-related disclosure frameworks for financial and non-financial corporates that are aligned with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations. Ratings and data products should also be aligned with these frameworks. Climate disclosure regimes should balance the objectives of consistency and flexibility to reflect that materiality is corporate-specific and should reflect decision-relevant information for financing decisions. This recognizes that corporates in similar sectors can be exposed to different material risks and opportunities, reflecting differences in individual business models and operating environments.

We therefore welcome IOSCO's work in this area and agree with the recommendation that regulators should focus attention on the transparency and use of ESG ratings and data products and ESG ratings and data providers in their jurisdictions, given their increasingly important role. The consultation paper highlights a number of challenges with the current market and we encourage IOSCO to continue its work to support consistent approaches to these issues. We believe that targeted guidance in some circumstances, and potential regulation in others, in this largely-unregulated area will be necessary to ensure transparency and integrity of the market, and that the focus should be on establishing governance and compliance requirements (for transparency towards both the covered entities and users of the information, integrity, conflicts of interest and commercial policies, as well as potentially, a certification system for providers) rather than IOSCO or its members establishing new ESG definitions, which should be left to the market.

We also urge IOSCO to ensure that regulators are not requiring the use of ESG ratings and data (either directly or indirectly), e.g. in disclosure, risk management, product construction, and scenario analysis expectations, without a strong understanding of the uses and limitations of those products. As one example, disclosure requirements can function as an indirect requirement to use ESG ratings and data from third-party providers. This can be problematic when regulatory requirements outstrip the maturity of data availability and quality.

Development of common industry standards or best practices may be a good first step here, since at present there is often inadequate transparency on methodologies employed, or on the sources of data or how it is being used, or how frequently it is updated, and by extension how reliable it is (e.g., publicly disclosed versus third party estimates or industry averages, stale ratings or data).

Considering this, it would be helpful to develop a set of principles for ESG ratings and data products, and associated use cases, which could be used to inform policy approaches, including self-regulatory efforts, guidance, or government regulation. This could include a consistent set of principles and definitions, while providing flexibility for regional, temporal and other variations to align with differences in practices and methodologies. A common industry lexicon and/or disclosure template also could help increase provider transparency on objectives, scope, methodologies and processes and would support greater clarity. This would also likely help to improve quality and transparency in the provisions of ESG rating and data services, and by extension would improve the quality of ESG-related ratings and data for users of such information. This would also be useful in providing greater clarity to covered entities about how their information is being used and for which purpose.

The challenge here is that different areas of the market and different use cases will merit different policy considerations and approaches. There is a broad range of products, services, and business models that make up the ESG ratings and data products marketplace, as well as a variety of use cases for ESG ratings and data.

Due to regional and sectoral nuances, pathways to transition will be different across jurisdictions and industries. For this reason, a single global structure similar to a taxonomy is unlikely to be viable; however, a consistent set of global principles could be applied across all jurisdictions and industries to ensure activities are aligned with IOSCO's goals.

As one example, a growing use of ESG ratings is for counterparty selection where ESG ratings are used in a manner similar to credit ratings. Using ESG ratings as a criteria for selection of potential counterparties, however, has the potential to negatively affect market liquidity and financial stability. If market participants can only select counterparties that have a certain ESG rating, this could potentially limit access to liquidity, which could be particularly problematic during times of stress. A firm's credit score could then be impacted as a result of clients limiting their counterparty selection, leading to broader implications and unintended consequences.

Where ESG ratings and data are used in a manner similar to credit ratings, a similar regulatory approach should be considered, with the same rigor as existing CRA processes. However, there are a variety of other use cases that implicate different policy considerations, and a one-size-fits-all approach will not be effective across the entire spectrum. For example, many asset managers use ESG ratings and data as an alternative data set within their research processes. In this case, market participants are using ESG ratings and data in a manner similar to sell-side analyst research reports—not similar to credit ratings. While asset managers experience significant challenges related to transparency and other issues, a policy approach oriented around guidance or best practices may be adequate to address those challenges.

While the safeguards provided by industry standards/best practices, along with other measures dealt with in the proposed Recommendations, may be sufficient for certain types of products and use cases, others may merit regulatory action to prevent the risk of green-washing, capital misallocation, conflicts of interest, and inadvertent product mis-selling.

We believe that the Recommendations in this consultation provide a good framework for any ESG rating and data providers' industry standards/best practices, and for appropriate regulation, and strongly support that market regulators, i.e. IOSCO members, be mandated to include ESG data providers and ESG rating providers in their scope of regulatory and supervisory responsibilities, as is currently the case for credit rating agencies.

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.

High quality ESG ratings and data products are extremely important, and necessary, for companies, as well as for investors and others in their assessment of a company's management of ESG risk and sustainability impact.

An example of the importance of high-quality ratings and data products can be found in a survey published last year by BlackRock of 425 investors (together representing $25 trillion assets under management), which found that poor quality or availability of ESG data and analytics represent the biggest obstacle to sustainable investing.

As an initial matter, we note that ESG ratings and ESG data are different and that issues around appropriate disclosure regulation, and market practice, should not be conflated between the two. In addition, robust data sets don't currently exist for many ESG issue areas, and the utility of different existing data sets needs to be more transparent. An example of a proposed framework for this analysis of the work of the Impact Management Project, which sets out an "ABC" framework that differentiates between data sets that might lead one to not invest in certain companies versus data that shows positive outcomes or impacts.

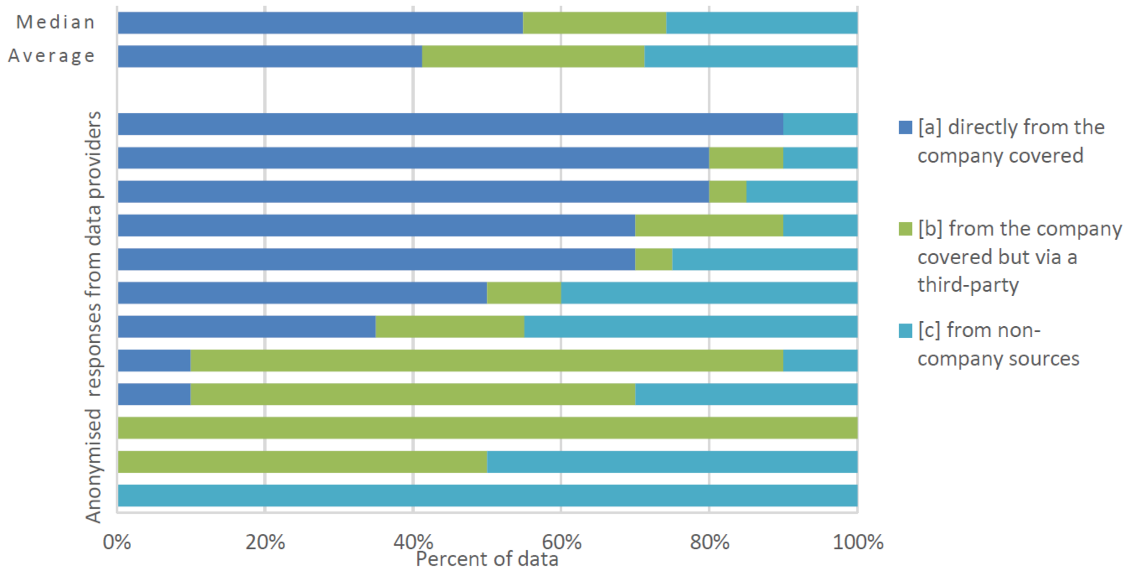
Three elements in this recommendation are crucial to improving the quality of ESG-related data products, and to enable users to determine whether a product is suitable for their particular use case:

(1) transparency around the source of ESG data (e.g., publicly disclosed, proxies/estimates, or other proprietary data), and the frequency with which that data is updated;
(2) transparency on product methodology in order for users to be able to determine quality and suitability of a product for their particular use case; and

(3) transparency on what a particular product is intended to measure (e.g., whether the product is measuring ESG risk or sustainability impact).

As described on page 24 of the consultation: "The methodological approaches underlying ESG ratings and data products are very diverse." Each ESG rating provider makes different choices about which ESG factors to consider and there is relatively large divergence between providers' methodologies and metrics, as well as among the products and areas covered.

Currently, there is variability regarding sources of data, with less than half of the data on average obtained directly from the company covered, as shown in the following chart from a recent European Commission study[3]:



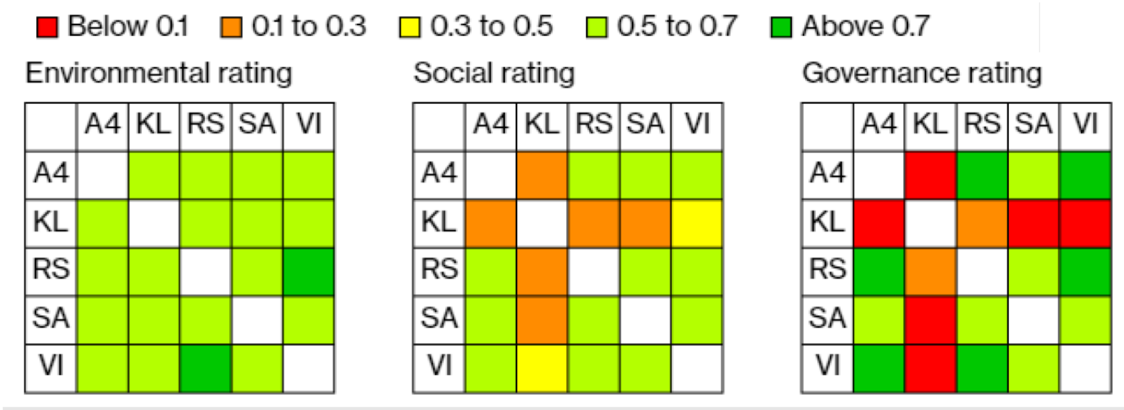
Providers also combine these metrics in different ways, applying different weighting and aggregation methodologies. These differences in methodologies can result in low correlation and high divergence in ESG ratings and data products between providers even where products are aiming to address the same objective, which may negatively affect the reliability and comparability of the information for investors and other stakeholders.

A recent study by the European Commission[4] demonstrates this low correlation, summarised in the following chart[5]:

[3] Study on Sustainability-Related Ratings, Data and Research, European Commission, November 2020, available at https://op.europa.eu/s/pLv3

[4] Id.

[5] In this chart, the following abbreviations are used: A4 (Refinitiv), KL (KLD), RS (S&P Global), SA (Sustained Analytics) and VI (Vigeo Eiris).



Source: MIT Sloan School of Management and Bloomberg

In some cases, this may also lead to multiple ratings for the same company, with the possibility of a company being rated very highly by one provider, while getting a low rating from another. Without sufficient transparency, users are unable to determine the drivers behind why two providers' ratings are different. This has the potential to negatively impact the company and cause significant market confusion for investors and other parties and could also increase opportunities for greenwashing or have other negative market impacts.

Again, an initial set of industry standard/best practices for ESG data and ratings which encourages greater transparency on data sources, methodology, handling of conflicts of interest, engagement with corporates and terminology, and which is designed to uncover and respond to practices such as greenwashing would be helpful as a first step. This could be used in conjunction with existing securities fraud enforcement mechanisms (including civil and other liabilities for false or misleading disclosures) to discourage and penalise such behaviour.

There are numerous providers of ESG ratings, data and other information, and this market is expected to continue to grow. As noted in the consultation, some predict that the market for ESG data products will reach $1 billion this year.

As noted, transparency and quality of ratings and data amongst providers can vary widely, and this variability may increase as the market continues to grow. While there are ESG rating and data providers that provide relatively high levels of transparency, there is much work to do to improve overall industry practices. We believe that these Recommendations can provide a good basis for improvement.

In order to encourage minimum standards, sourcing of all data should be fully transparent for every indicator on the ESG report, including:

- Date and location of the data;

- Whether data was company disclosed vs “alternative data” vs calculated/ resultant/ output data;
- Whether the company disclosed (and alternative) data has been verified and to what level of assurance has been obtained.

Perhaps introduction of a tiered or graded assurance level system could be considered to reflect the quality, integrity and level of certainty around of the data employed in determining the ratings (e.g., verified, up-to-date publicly sourced or proprietary data being a pre-requisite for a 'grade 1' rating, for instance, whilst ratings based on unverified industry averages with (potentially) no company data involved would be attributed the lowest grade).

Similarly, disclosure of methodologies needs to become market standard so that investors can more easily decide which investments really fit with the needs of their portfolios. With respect to ESG Rating Report transparency, there should be a requirement to disclose breakdown of scoring methodologies (e.g., what contribution each individual indicator has in the scoring of a management assessment).

In addition, more granular business profile assessments (geographic as well as business type. i.e., beyond industry level) should be provided with related transparency, including how much of the assessment is industry based as opposed to company based. Finally, transparency on the provider’s weight setting approach and/or material issue selection approach at the industry level should be provided, including an indication of how it is determined. An example can be found in the CDP’s scoring methodology.[6]

Maintaining records to support findings under ratings analyses (and updating them (if required) on either an annual or issue by issue basis) should also be encouraged, not least to ensure that new ratings' company personnel can be quickly brought up to speed to reduce the administrative burden on the companies rated (where company interaction is involved).

As acknowledged in the consultation paper, the significant efforts to improve the availability and comparability of ESG data, including the work under WS1 and the introduction of disclosure requirements in some jurisdictions, should also help improve the quality of ESG ratings and data.

Clarity and transparency on what different ratings and data products are intended to measure and capture is extremely important and not always clearly articulated. For example, it is not always clear whether a product is intended to measure ESG risk to an organization or the sustainability impact of that organization. While ESG risk and sustainability impact can be related, they are different measures that should not be conflated. Without clarity, ESG ratings and data products that are sustainability impact oriented may be inappropriately used to measure ESG risk.

[6] CDP Scoring Methodologies https://www.cdp.net/en/guidance/guidance-for-companies#983f54421cac095b304bb72361ae1e38

This can be particularly problematic in the context of integrating ESG ratings or data into credit ratings, where ESG risk should be approached through the same lens and with the same rigor as existing CRA processes. It is therefore essential that providers offer clarity and transparency on what different ratings and data products are intended to measure.

We also note that the use of ESG data and ratings goes beyond listed corporates and their investors. It also includes other actors in the supply chain ecosystem who will need to utilize the same data in order to make informed choices on who they source or partner with. Listed corporates are dependent on wider supply chain networks and their ability to disclose the right information. Therefore, we note that transparency in data and ratings aren't just crucial for corporate funding, but also for the transition of the wider economy.

Lastly, as stated above in response to Recommendation 1, market regulators, exchanges and accounting standards boards, in consultation with corporates, banking and capital markets firms, and investors, should continue to develop consistent climate-related disclosure frameworks for financial and non-financial corporates that are aligned with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations. This work will help ensure greater availability of ESG data disclosed by companies which in turn will support improved quality of ESG ratings and data products.

In this respect, ESG disclosure regimes should balance the objectives of consistency and flexibility to reflect that materiality is corporate-specific and should reflect decision-relevant information for financing decisions. This recognizes that corporates in similar sectors can be exposed to different material risks and opportunities, reflecting differences in individual business models and operating.

We believe that an increased focus on resolving the matters raised above, even in the short term in the form of non-binding guidance or recommendations before robust industry standards/best practices, and regulatory frameworks, are settled, would also increase competition among providers to produce high quality ESG ratings and data and to provide greater transparency about the related methodologies and metrics, therefore helping to drive industry standards in the right direction.

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.

We agree with this recommendation. We re-emphasise our response to Recommendation 1 regarding further regulatory oversight and how industry standards/best practices and targeted regulation could help alleviate such concerns. Specific attention should be given to conflicts of interest management at a time of increasing concentration of the market as well as the rapid development of the commercial offer of ESG-related product/services towards covered entities and users. The activities of ESG rating agencies and data providers' subsidiaries and parents' companies should also be considered where relevant.

We also suggest that it would be helpful to explore the implementation of principles around a fair and transparent commercial policy towards data users given steady increasing concentration of this market.

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.
We do not necessarily agree that these issues should be "consider[ed], on a best effort basis", partly because it is unclear how much effort would be required to comply with such a subjective standard.

It might be more helpful to address these concerns by having ESG rating and data providers give information on how they are identifying, managing and mitigating these compromises.

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.

It is very important that the market have confidence in the quality and reliability of ESG ratings and data, and high levels of transparency and public disclosure would be helpful in that regard.

Otherwise, please see our response to Recommendation 2.

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.

In some situations, this might present a significant challenge to a publicly listed company that is sharing non-public information with a ratings or data product provider, without assurance that the information will be kept confidential. Anything that might affect the company's ESG ratings could be, arguably, material enough to affect the pricing of their securities and therefore might be considered as inside information.

Therefore, ESG ratings and data product providers would be considered and treated as insiders, and the company would likely disclose any information to such providers on the condition that the providers have given assurances the information will be kept confidential and will not be leaked and for this reason, we do not believe that this Recommendation would be necessary. Each company and ESG rating provider should make their own assessments in disclosing and receiving information and should ensure compliance with applicable regulations.

We have broader concerns about ESG ratings providers asking companies to share Material Non-Public Information (MNPI). ESG ratings products are explicitly intended to inform investment decisions and other capital markets activity, and it would seem problematic to incorporate MNPI into an ESG rating that will then be sold to investors
.

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.

Asset managers and other financial intermediaries who rely on third-party services for ESG-related ratings and data products are generally expected to have carried out some level of due diligence on their providers. Increased transparency into the data sources, methodology, and product purpose will only improve ESG product users' ability to determine whether a particular product is well suited for their purposes.

This further highlights the need for improved company disclosure, as well as for increased transparency around the methodologies and metrics used to derive ESG ratings and data. Likewise in the context of securities offerings, companies and underwriters should ensure that adequate due diligence was conducted around the ESG ratings and data, particularly to the extent that this is presented in the offering documentation.

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.

We agree with this Recommendation, although we appreciate the challenges which may arise in certain industries and/or geographies due to lack of available information or access thereto.

Effective ESG disclosure requires adequate and meaningful engagement between providers of ESG ratings and data products and the companies that are subject to such ratings and data products. Currently, such engagement does not occur with enough consistency.

Because of the wide breadth and potential complexity of issues related to ESG, it is essential that the provider of ESG ratings information and data products have a clear view of the company's business, financial situation, and present and future objectives and plans, among other things.

The provider must also make an assessment of how these factors might affect important questions of materiality and proportionately. It is much more difficult, without meaningful engagement with the company, for the provider to undertake these materiality and other analyses and assessments, as well as for investors and other stakeholders to obtain a fully accurate and complete picture of the company's management of ESG risks and sustainability impacts.

There are also concerns that limited engagement precludes the company from correcting errors or misconceptions prior to publication of the rating or data. Since the rating or data can have a wide-ranging effect on market perceptions of the company and its ability to raise capital, any correction or further clarity provided after the fact might be too late. It would be helpful to provide a more structured framework for such engagement, including possibilities for companies to have a right of review before an ESG rating or data product is published.

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.

We agree with this Recommendation.

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.

We agree that improving ESG disclosures is imperative to increase the quality of information available to market participants—including ESG ratings and data providers, and financial institutions seeking to undertake due diligence and risk assessments.

The consultation recognises that there is currently wide divergence in company ESG reporting requirements, which is the main source of the 'raw data' used to compile the ESG ratings. This divergence is also highlighted from a practical standpoint in AFME and Latham & Watkin's "ESG Disclosure Landscape for European Banks and Capital Markets"[7], which compares in detail the global reporting requirements of the TCFD to a wide variety of European financial institution regulation requirements.

[7] https://www.afme.eu/Portals/0/DispatchFeaturedImages/FINAL_%20AFME%20White%20Paper_%20ESG%20Disclosure.pdf

We welcome IOSCO's efforts to support the work of the IFRS Foundation towards the establishment of an International Sustainability Standards Board (ISSB), in coordination with coordinated regional initiatives and implementations. We believe that completion of the work under Workstream 1 to establish, through the ISSB, an international baseline for sustainability reporting standards should make it much easier to streamline disclosure in formats that are readily useful for ratings and data providers.

In the context of the current consultation, it may be more efficient for IOSCO to continue its participation in ongoing international efforts rather than introducing separate recommendations about the location of sustainability-related disclosures, which are currently embedded within Recommendation 10 for Covered Entities.

Allison Parent

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