

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

Final Report



OICU-IOSCO

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

FR09/21	NOVEMBER 2021
----------------	----------------------

Copies of publications are available from:
The International Organization of Securities Commissions website www.iosco.org
© *International Organization of Securities Commissions 2021. All rights reserved. Brief excerpts may be reproduced or translated provided the source is stated.*

Contents

Executive Summary	1
Introduction.....	3
Chapter 1: Product and Market Overview	6
Chapter 2: ESG ratings and Data Products Providers.....	16
Chapter 3: Private and Public Users of ESG ratings and Data Products	24
Chapter 4: Companies and ESG Ratings and Data Products Providers.....	28
Chapter 5: Final Recommendations	32
Annex 1: Glossary.....	44
Annex 2: Final IOSCO Recommendations	46
Annex 3: WS3 Consultation Report Feedback	48

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 providers¹ 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.

IOSCO issued a Consultation Report on 26 July 2021 which explored these developments and challenges and sought to better understand the implications of the increasingly important role of ESG ratings and data products for financial markets.² It did 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 broadly treated the same in this Report for efficiency. However, not everything stated to apply to ESG ratings providers may apply to ESG data products providers, and vice versa.

¹ 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.

² CR02/2021 Environmental, Social and Governance (ESG) Ratings and Data Products Providers, available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD681.pdf>

We received a total of sixty-one (61) responses to the Consultation Report. A summary of the responses is provided in Annex 2 of this Report. Overall, respondents were supportive of IOSCO's work and were broadly in agreement with the proposed recommendations set out in the Consultation Report. The IOSCO Board is grateful for the responses received and took them into consideration when preparing this Report.

The Final Report (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 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 recommendations start with a proposal that regulators could consider focusing greater attention on the use of ESG ratings and data products and the activities of ESG rating and data products providers in their jurisdictions. This is followed by a set of recommendations addressed to ESG ratings and data products providers, setting out that they could 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 recommendations also suggest that users of ESG ratings and data products could consider conducting due diligence on the ESG ratings and data products that they use within their internal processes. The recommendations close with suggestions that ESG ratings and data products providers, and entities subject to assessment by ESG ratings and data products providers could 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 ratings 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.³

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%, while ESG indexes could grow by 35%.⁴

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

³ For example, asset managers in the EU 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)

⁴ 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.⁵ 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.

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 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.

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). The IFRS Foundation launched the new board at the United Nations (UN) Climate Summit (COP 26) in November 2021.

IOSCO has strongly supported the IFRS Foundation in its work towards delivering 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 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.

⁵ 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.

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. Prior to launching the ISSB, the IFRS Foundation trustees convened a working group to develop recommendations to give the new board a ‘running start’. Consistent with IOSCO’s vision, this technical readiness work leveraged the TCFD Framework and other content from existing sustainability reporting organisations.

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.⁶

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 users’ trust 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.⁷

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. 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.

⁶ The STF Workstream 1 report can be accessed at the following link:
<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD678.pdf>

⁷ The STF Workstream 2 report can be accessed at the following link:
<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD688.pdf>

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.⁸ Nonetheless, KPMG estimates that there are 160 ESG ratings and data products providers worldwide.⁹ These include both for-profit and non-profit companies that offer large or specialised ESG-related products. At a regional level, a report recently prepared for the European Commission (EC) identified 30 to 40 other smaller providers of ESG ratings, data and research products and services domiciled in the European Union (EU), although such data is harder to find in other jurisdictions.¹⁰ From a revenue perspective, according to a recent study by UBS, global revenues generated by ESG data and services could more than double by 2025.¹¹

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.

Providers and consolidation

⁸ 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).

⁹ KPMG, Sustainable Investing: Fast-Forwarding Its Evolution, February 2020 available at <https://assets.kpmg/content/dam/kpmg/xx/pdf/2020/02/sustainable-investing.pdf>.

¹⁰ 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>.

¹¹ <https://www.ubs.com/global/en/investment-bank/in-focus/covid-19/2020/esg-data-and-services.html>

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 1) 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.

Table 1: Examples of recent mergers and acquisitions in the ESG ratings and data provision market.		
Year	Target	Acquirer
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)	Thomson Reuters (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 (SMEs), 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 UN 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 2 alongside a reminder of how these terms are to be understood within this Report.¹² 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.

Table2: Overview of ESG ratings and Data Products - Sample Provider 1	
1	Controversy Activity Screening: Assessment of a company's level of involvement in 17 controversial activities
2	Controversial Weapons Screenings: Assessment of a company's involvement in 10 types of weapons
3	Controversy Risk Assessments: Aggregate view of a company's exposure to and management of ESG and Climate related controversies
4	Sustainable Goods and Services Assessments: 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	Sustainable Development Goals (SDG) Assessments: Measures a company's level of contribution across the SDGs through their products & services and business behaviour
6	UN Global Compact Assessment: Normative framework assessment of a company's capacity to manage ESG responsibilities outlined by the UN Global Compact
7	Corporate ESG Assessments and Scores: 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	Sovereign ESG Assessments and Scores: Scores a Sovereign entity's performance on 172 ESG risk and performance indicators
9	Sustainability Ratings: 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	ESG Benchmark Analysis: Customised peer benchmarking for a company including ESG assessment ranking and best practice insights
11	Corporate Physical Climate Risk Scores: Asset-level data on exposure to floods, heat stress, hurricanes and typhoons, sea level rise, water stress and wildfires
12	Sovereign Physical Climate Risk Scores: Aggregate physical climate risk scores for each jurisdiction based on the total and percentage of agriculture, population and GDP (purchasing power parity) exposed.
13	Corporate Transition Risk Scores: • Brown share data to assess exposure to fossil fuels, including a company's revenue, reserves, potential emission and power fossil fuels • Carbon footprint measuring a company's carbon emissions • Temperature alignment assessing how a company's emissions reduction targets align with different temperature pathways.
14	Energy Transition Score: Measures a company's preparedness for the transition to a low-carbon economy.

¹² 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>

Table2: Overview of ESG ratings and Data Products - Sample Provider 1	
15	Physical Risk Management: Demonstrates how a company anticipates, prevents and manages physical risks.
16	TCFD climate strategy: Analyses how a company's disclosures align with the TCFD's recommendations.
17	Sovereign Transition Risk: Measures emission by jurisdiction covering its whole production-based emissions and carbon intensity (emission per unit of GDP).
18	Daily Monitoring and Alerts: 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:

Table 3: Overview of ESG ratings and Data Product Offerings: Sample Provider 2	
1	Carbon Risk Rating 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	Climate Solutions 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	Controversial Weapons Screening 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	Energy & Extractives Screening Assesses companies' involvement in the extraction of fossil fuels and the generation of power from fossil fuel, nuclear and renewable sources.
5	E&S Disclosure Quality Score Measures and identifies companies' environmental, social and governance disclosure practices with data-driven scoring and screening solutions.
6	Global Sanctions Screening Assesses companies with ties to jurisdictions of concern and/or jurisdictions under UN United States (US) or EU sanctions.
7	Norm-Based Research 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	Pooled Engagement 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	Sector-Based Screening Assesses companies' involvement in sectors and products such as alcohol, animal welfare, cannabis, for-profit correctional facilities, gambling, pornography, and tobacco.
10	SDG Solutions Assessment Determines the positive or negative impact of companies' product and service portfolios on the UN Sustainable Development Goals.
11	ESG Index Solutions 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	Cyber Risk Helps investors, insurers and companies to accurately assess, continually monitor, and judiciously benchmark enterprise cyber risk management programs

Table 3: Overview of ESG ratings and Data Product Offerings: Sample Provider 2	
13	EU Taxonomy Alignment Solution 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	Jurisdiction Ratings 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	ESG Corporate Rating 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	SDG Impact Rating Determines a company’s positive or negative impact on the UN 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.¹³ 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. On that basis, ratings may therefore incorporate an element of analytical judgement or opinion. 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 are¹⁴) 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 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.

¹³ 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.

¹⁴ <https://www.sustainalytics.com/esg-data>

- **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.

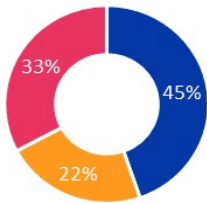
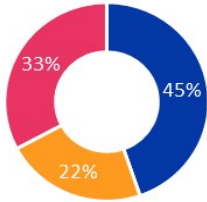
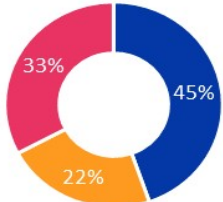
ESG ratings products

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. There is also more coverage of larger companies over SMEs. 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.

Table 4: Example Statements Provided by Stakeholders During IOSCO Fact-Finding Exercise
ESG ratings/data coverage can depend on sophistication of financial market
<i>The individual ESG scores are geographically diverse across developed markets with higher coverage in well-developed markets as data disclosure increases.</i>
Coverage of private unlisted companies less systematic than publicly listed companies
<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> • <i>ESG demand in these asset classes is relatively new and there is yet to be sufficient demand for a systematic coverage,</i> • <i>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.</i>

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 developmental 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.

Table 5: Sample level of ESG ratings Coverage of publicly listed companies by major geographic region from US Headquartered ESG ratings and data provider.									
Products	Coverage by Region								
Carbon Risk Ratings	 <table border="1"> <caption>Carbon Risk Ratings Coverage by Region</caption> <thead> <tr> <th>Region</th> <th>Coverage (%)</th> </tr> </thead> <tbody> <tr> <td>EMEA</td> <td>45%</td> </tr> <tr> <td>AMER</td> <td>33%</td> </tr> <tr> <td>APAC</td> <td>22%</td> </tr> </tbody> </table>	Region	Coverage (%)	EMEA	45%	AMER	33%	APAC	22%
Region	Coverage (%)								
EMEA	45%								
AMER	33%								
APAC	22%								
ESG Corporate Ratings	 <table border="1"> <caption>ESG Corporate Ratings Coverage by Region</caption> <thead> <tr> <th>Region</th> <th>Coverage (%)</th> </tr> </thead> <tbody> <tr> <td>EMEA</td> <td>45%</td> </tr> <tr> <td>AMER</td> <td>33%</td> </tr> <tr> <td>APAC</td> <td>22%</td> </tr> </tbody> </table>	Region	Coverage (%)	EMEA	45%	AMER	33%	APAC	22%
Region	Coverage (%)								
EMEA	45%								
AMER	33%								
APAC	22%								
SDG Impact Ratings and SDG Solutions Assessment	 <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>EMEA</td> <td>45%</td> </tr> <tr> <td>AMER</td> <td>33%</td> </tr> <tr> <td>APAC</td> <td>22%</td> </tr> </tbody> </table>	Region	Coverage (%)	EMEA	45%	AMER	33%	APAC	22%
Region	Coverage (%)								
EMEA	45%								
AMER	33%								
APAC	22%								
AMER APAC EMEA									

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.

Table 6: Comments Provided by Stakeholders During IOSCO Fact-Finding Exercise	
Comparison of the most common ESG data products used by clients of two ESG [ratings and] data products providers	
• ESG Scores • Daily Monitoring and Alerts • Corporate Physical Climate Risk Scores • Corporate Transition Risk Scores • Controversial Activity Screening	• Sector-Based Screening • Norm-Based Research (NBR) and Sovereign NBR • Controversial Weapons Research • Climate Solutions

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 US. 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 US, 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.

Table 7: Example Statements Provided by Stakeholders During IOSCO Fact-Finding Exercise
Greater use of ESG data products prevalent in certain jurisdictions
<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 US, there is a strong demand for raw data, but Sector-Based Screening, Controversial Weapons Research and Climate Solutions are also relatively popular.</i>
Preferences for certain products also exist within jurisdictions
<i>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 US for our Corporate Physical and Transition Risk scores.</i>

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.¹⁵

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,¹⁶ industry associations,¹⁷ 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 identified only a limited number of national regulatory frameworks applicable to providers of these or similar products. For example, the legal and regulatory framework in the EU for benchmarks¹⁸ and United Kingdom¹⁹ may be relevant for certain providers of benchmarks with an ESG or climate dimension.

However, this framework is not directly relevant for the broad scope of ESG ratings and data products as described and foreseen in this report. As a result, the current situation would appear to be one in which there are few examples of legal and regulatory frameworks of direct relevance for ESG ratings and data products, and no voluntary frameworks of direct relevance, outside of those being applied more generally by providers of Financial Benchmarks.

¹⁵ A non-exhaustive list of these firms being: MSCI, Sustainalytics, Vigeo Eiris, Arabesque

¹⁶ 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.

¹⁷ AFEP-MEDEF: French Initiative on the relations between Companies and Non-Financial Rating Agencies

¹⁸ Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation EU (No 596/2014)

¹⁹ <https://www.legislation.gov.uk/ukxi/2019/657/contents/made?view=plain>

Table 8: Example Statements Provided by Stakeholders During IOSCO Fact-Finding Exercise
Voluntary Frameworks for certain aspects appear to be the norm
<i>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.</i> <i>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).</i>

Some jurisdictions are currently developing frameworks for regulating ESG ratings and data products providers. For example, the EC announced it is investigating the market for sustainability ratings and research as part of its 2018 Action plan for sustainable finance. Subsequently, the EC published its Strategy for Financing the Transition to a Sustainable Economy in which it outlined that it would take action to improve the reliability and comparability of ESG ratings and further assess certain aspects of ESG research, to decide on whether an intervention is necessary.²⁰

In the UK, in 2021 the Financial Conduct Authority (“FCA”) published a discussion chapter seeking feedback on certain ESG issues in capital markets, including the currently unregulated field of ESG data and ratings. The consultation set out governance, transparency and conflicts²¹ issues in this area and asked stakeholders whether there is a case for regulatory intervention in this market. More recently, the UK HM Treasury published a roadmap²² to sustainable investing in which it confirmed that the government is considering bringing relevant firms into the scope of FCA authorisation and regulation.

²⁰ [Action 4 of the European Commission’s Strategy for Financing the Transition to a Sustainable Economy](#)

²¹ <https://www.fca.org.uk/publication/consultation/cp21-18.pdf>

²² https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1031805/CCS0821102722-006_Green_Finance_Paper_2021_v6_Web_Accessible.pdf

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.

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.

Table 9: Measurement Objectives of Selected ESG ratings	
Example statements Provided by Stakeholders During IOSCO Fact-Finding Exercise	
Differences in ESG ratings Measurement Objectives	
ESG ratings Provider 1	ESG ratings Provider 2
<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>	<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>
<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>	<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> <i>Conversely, which ESG issues affecting an industry may turn into opportunities for companies in the medium- to long- term.</i>

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 10: Example Statements Provided by Stakeholders During IOSCO Fact-Finding Exercise
Collection of ESG data hampered by multiple factors
Low Volume of ESG Information <i>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.</i> ESG Reporting Fragmentation <i>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.</i> Issues with Supporting Information for Targets <i>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.</i> Lack of Key Performance Indicator (KPI) Consistency <i>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.</i>

IOSCO has worked 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.²³ 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, 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 ratings or data product were to increase, this would increase the financial benefit or incentive for an issuer to pay for the ESG ratings or data product.

Depending on the remuneration model put in place, the potential risks of conflicts of interest will differ. 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 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.

²³ IOSCO press release dated 24 February 2021, available at: <https://www.iosco.org/news/pdf/IOSCONEWS594.pdf>

Table 11: Example Statements Provided by Stakeholders During IOSCO Fact-Finding Exercise
ESG data fee’s model is predominantly “subscriber pays”
<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 ratings and Data Products Providers] ESG ratings, our flagship offering, in order to benchmark their ESG practices against industry peers.</i>
But market could shift in coming years
<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.²⁴

²⁴ 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 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*.

A recent report by the OECD describes some of these differences in methodologies among providers:²⁵

- 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.

²⁵ 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.

Table 12: Example Statements Provided by Stakeholders During IOSCO Fact-Finding Exercise
Use of Sector- Specific Methodologies for ESG ratings and data products
<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.

Table 13: Example Statements Provided by Stakeholders During IOSCO Fact-Finding Exercise
Use of artificial intelligence and machine learning techniques evidenced but still at early stage
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 information gathering exercises by ESG ratings and data products providers

The fact-finding exercise revealed a wide range of information gathering practices performed by ESG ratings and data products providers. The practices for information gathering 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: scrutinising 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), checks against other sources such as governmental databases, and deviations against a peer group or against previous years.

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

Table 14: Example Statements Provided by Stakeholders During IOSCO Fact-Finding Exercise
Information gathering by ESG ratings and data products providers
<i>Information disclosed by companies is generally scrutinised 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.

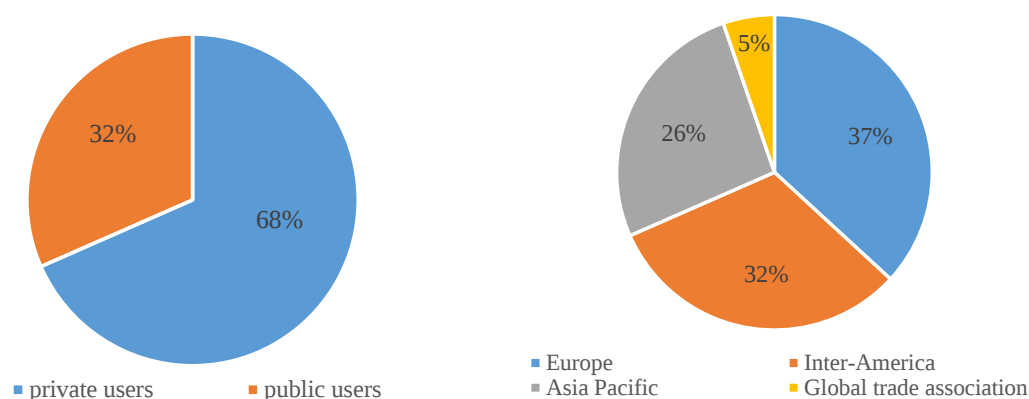
Table 15: Example Statements Provided by Stakeholders During IOSCO Fact-Finding Exercise
Use of benchmarking against other providers
<i>[ESG ratings and data products provider] does not directly compare its ESG ratings to that of other ESG ratings providers. As discussed previously, the methodologies 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.

Table 16: Objectives of using ESG ratings and ESG data products	
ESG ratings	ESG data products
• Manage sustainability-related risks or opportunities • Design and oversee sustainable products • Guide engagement strategies that drive positive change in the invested companies • Guide corporate sustainability initiatives • Report to clients • Monitor external asset managers as trustee by assessing the exposure of ESG and climate risks	• Manage sustainability-related risks or opportunities • Meet compliance with CSR policy • Negative screening (e.g. products that provide names of companies producing weapons) • Offer sustainable investing products • Meet regulatory reporting requirements • Analyse environmental impacts (e.g. GHG emissions, carbon intensity, monitoring the alignment of the financial portfolio to the Paris Agreement)

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 on a “subscriber-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.

Table 17: Examples of approaches to due diligence	
Before the agreement with providers	After the agreement with providers
• Check quality control processes • Check governance and transparency of providers by visiting providers’ offices and conducting Q&A session (e.g. to check whether internal processes to build methodologies are well governed). • Verify whether criteria used in assessment process are science based, quantitative, verifiable and aligned with existing standards and taxonomies.	• Go back to data sources (e.g. annual reports) when identifying data discrepancy or abnormal data. • Engage with providers when identifying defective data to check to what extent data products reflect the current practices of entities • Ask providers for clarification/further information about the result of ESG ratings.

It was also highlighted that regardless of the sequencing of the due diligence exercise, users of ESG ratings and data products could benefit from evaluating whether the criteria utilised in the assessment process are science based, quantitative, verifiable and aligned with existing reputable standards and taxonomies. These due diligence processes could be expanded to include an evaluation of the relative weighting of these criteria in the process as well as the extent of the qualitative judgement exercised by the ESG ratings or data provider.

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. 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.²⁶

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

The fact-finding exercise showed that the majority of respondents had 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 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

²⁶ 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.

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.

Table 18: Views of Companies: Data Collection

- | |
|---|
| <ul style="list-style-type: none"> • Time consuming to respond to questionnaires of differing frequency and focus. • Limited forward visibility on receipt of requests for information from providers. • Lack of explanation for questions being addressed to covered entity |
|---|

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.

Table 19: Views of companies regarding interaction phase 2: Data assessment
• Lack of transparency of the rating or data product methodology and criteria (the “black-box”; ESG factors, weight, absolute and relative scoring) • Limited explanation of the outcome • Interpretation of the ranking or outcome • Ranking or assessment criteria • Limited explanation of the final assessment • Change of rating or data product methodologies without publication or notification

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 ratings 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 ratings 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.

Table 20: Views of companies regarding interaction phase 3: Pre-publication
• 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 • Lack of opportunity to amend incorrect information • Tight deadline for review • Ineffective amendment after publication of final report • Risk of investment decision based on inaccurate information without review in advance of publication

Potential conflicts of interest

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 ratings 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: Final 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 and also included a request for further information at the consultation stage. IOSCO asked ESG ratings and data products providers to identify practical steps that could be taken to improve the usability and reliability of the information entities currently disclose. Respondents suggested the following:

- entities 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.²⁷
- entities 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.
- entities could provide more transparency about the timing of disclosures and dialogues with ESG ratings and data products providers. For example, respondents suggested that if, at the start of the year, entities were to publish a calendar for when and where their ESG disclosures were to be made, this would help ESG ratings and data products providers align their review frequencies with the availability of information.
- there could be more dialogue between entities 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 ratings and data products.

Based on the fact-finding exercise and consultation responses, 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.

²⁷ 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 ratings 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 help 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 entities, 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 entities

As noted in Chapter 4, the lack of interaction between ESG ratings and data products providers and entities 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 entities 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 entities. Similar to the feedback received from users of ESG ratings and data products, some entities have asked for clearer and more transparent disclosure of information on how an ESG ratings 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 entities 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 entities 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 entities.

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; support which also came through the responses to IOSCO's consultation report. 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 recommendations addressing the key areas of concern.

Overview of Recommendations

Based on specific suggestions and stakeholder feedback received from the fact-finding exercise conducted by the STF, as well as the public consultation responses, this chapter sets out high-level recommendations and guidance on possible policies and procedures for meeting the objectives of the recommendations. The suggestions for policies and procedures are provided as guidance on the implementation of the goals of the high-level recommendations. They are intended to serve as illustrations for specific steps that can be voluntarily taken for each recommendation. They are intended as helpful concrete suggestions that regulators could consider as ways to address recommendation 1 and that market participants could consider with respect to recommendations 2-10. Given the nascent and developing nature of the ESG ratings and data products market, the guidance on policies and procedures might need to be updated as the ESG industry evolves.

The set of recommendations are provided according to 5 sections:

- Section 1 provides recommendations on possible regulatory and supervisory approaches.
- Section 2 provides recommendations on the internal processes of ESG ratings and data products providers.
- Section 3 provides recommendations concerning the use of ESG ratings and data products.
- Sections 4 and 5 provide 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 recommendations could be implemented may depend upon the priorities of stakeholders, local market circumstances and jurisdictions' legal and regulatory frameworks. For their part, ESG ratings and data products providers, and entities covered by ESG ratings and data products providers, could consider inclusion of the relevant provisions in their internal policies and procedures. In some cases, regulators could consider the recommendations in the development of their regulatory frameworks or in the supervision of their supervised or regulated entities. Regulators could also consider whether their existing regulatory regimes are sufficient for oversight, or, where appropriate, clarify or expand their existing regulatory regime where additional regulatory authority may be appropriate.

5.1 Recommendations for Authorities concerning ESG ratings and data products

Where regulatory or supervisory authorities have authority over ESG ratings and data products providers, they could 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 of the providers. This could include the possibility of establishing regulatory expectations around good practices in corporate governance to help ensure appropriate independence, objectivity and challenge at board or other appropriate level within the providers.

The recommendations focus on ways through which authorities could enable ESG ratings and data products providers to deliver high quality and independent ESG ratings and data products, whilst appropriately addressing conflicts of interest. The ESG ratings and data products market is still developing and includes a diverse range of providers and products covering for example, aggregated ESG assessments as well as analyses of individual E, S and G issues, using different approaches. This diversity of views, independent methodologies, innovation and competition can be beneficial to the markets and investors, with sufficient transparency and robust governance, calling for providers to issue ratings and data products that are internally consistent with their own disclosed in-house methodologies. The implementation of these measures 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 helping to protect investors and ensure that markets are fair and efficient, in line with IOSCO objectives. However, mechanistic or over-reliance on ESG ratings or data products should be avoided. For this reason, it is not recommended that regulators use ESG ratings in legal, regulatory or supervisory frameworks (e.g., for disclosure, risk management, product construction or scenario analysis) as the basis for compliance.

Where regulators have authority over Credit Rating Agencies (CRAs) or exchanges that also issue ESG ratings and data products, these regulated entities should consider whether there exists the potential for conflicts of interest between a CRA's or an exchange's offerings and its ESG ratings or data product offerings, and if so, the steps they could consider to mitigate and address those potential conflicts of interest.

Finally, regulators, could consider whether there are opportunities to encourage industry participants to develop and follow voluntary common industry standards or codes of conduct and IOSCO could also consider what role it can play in supporting the development of such voluntary standards or codes.

Recommendation 1: Regulators could consider focusing more attention on the use of ESG ratings and data products and ESG ratings and data products providers that may be subject to their jurisdiction.

- Regulators could examine their existing regulatory regimes and where applicable consider whether there is sufficient oversight of ESG ratings and data products providers.
- Regulators could support voluntary industry-led development of standardised definitions for the terminology used and referred to by ESG rating and data products providers.

- Where regulators have authority over ESG ratings and data products providers, they could consider:
 - Requiring the provider to identify, disclose and, to the extent possible, mitigate potential conflicts of interest that may arise between ESG ratings and data product offerings and other relationships with the covered entities such as provision of third party opinions for green finance products and ESG consulting services.
 - Whether the corporate governance organisational and operational structures of the provider are sufficient to identify, manage and mitigate any potential 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 providers' ESG ratings and data products are issued in a manner that is internally consistent with the relevant provider's in-house methodologies.
 - Whether the underlying processes and methodologies of the ESG ratings and data products are subject to the provider's written policies and procedures and/or internal controls designed to help ensure the processes and methodologies are rigorous, systematic, and applied consistently.
 - Whether to provide facilities for the reporting of complaints or misconduct relating, but not limited to, the independence, transparency or integrity of ESG rating or data products.
- Regulators, could consider whether there are opportunities to encourage industry participants to develop and follow voluntary common industry standards or codes of conduct. IOSCO could also consider what role it can play in supporting the development of such voluntary standards or codes, regarding:
 - the identification, management and mitigation of potential conflicts of interest for ESG ratings and data products providers;
 - the integrity, transparency and independence of ESG ratings and data product methodologies; and/or

the disclosure of ESG rating and data products terminology to help improve understanding of these terms in the markets.

5.2 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.

The focus of these recommendations is on the providers' production of high quality ESG ratings and data products, consistent with the internal methodology and procedures of the ratings or data products provider. IOSCO has provided recommendations regarding transparency and the providers' internal consistency in the application of the in-house 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 provide high level recommendations for ESG ratings and data products providers that are sufficiently flexible to accommodate a diversity of views, innovation and competition within the context on the developing nature of this market.

Recommendation 2: ESG ratings and data products providers could consider adopting and implementing written procedures designed to help ensure the issuance of 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.

- ESG ratings and data products providers could consider:
- adopting and implementing written policies and procedures designed to help ensure that the ESG ratings and data products they issue are based on a 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 while maintaining a balance with respect to proprietary or confidential aspects of the methodologies.
 - for ESG ratings, publishing on a regular basis an evaluation of their methodologies against the outputs which they have been used to produce.
 - subjecting these methodologies 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, where reasonably possible, 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, and the time period that data is relevant to as well as whether the data is publicly sourced or proprietary in nature, including through approximations.
 - monitoring on an ongoing basis, and regularly updating, their ESG ratings and data products, except where specifically disclosed that the rating is a point in time rating.

- o maintaining internal records to support their ESG ratings and data products.
- o 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, analyse all the information relevant to their decision-making processes, and provide quality assurance.
- o how to ensure personnel involved in the deliberation-of ESG ratings and data products are professional, competent, and of high integrity.
- o Offering ESG ratings and data products to clients in a machine-readable format.

Recommendation 3: ESG ratings and data products providers could consider adopting and implementing written policies and procedures designed to help ensure their decisions are independent, free from political or economic interference, and appropriately address potential conflicts of interest that may arise from, among other things, 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 and their officers and employees.

Recommendation 4: ESG ratings and data products providers could consider identifying, avoiding or appropriately managing, mitigating and disclosing potential conflicts of interest that may compromise the independence and objectivity of the ESG rating and ESG data products provider's operations.

- ESG ratings and data products providers could consider:
 - o adopting written internal policies and procedures and mechanisms designed 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.
 - o disclosing such conflict avoidance and management measures.
 - o taking steps to help ensure the ESG ratings and data 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 entity or any other party for which it provides ESG ratings or data products.
 - o putting in place measures to help ensure their staff members refrain from any securities or derivatives trading presenting inherent conflicts of interest with the ESG ratings and data products.
 - o structuring reporting lines for their staff and their compensation arrangements to eliminate or appropriately manage actual and potential conflicts of interest related

to their ESG ratings and data products.

- o not compensating or evaluating staff on the basis of the amount of revenue that an ESG rating and data products provider derives from an entity that staff provides ESG ratings and data products for, or with which staff regularly interacts regarding such ESG ratings and data products.
- o where consistent with confidentiality, contractual and other business, legal and regulatory requirements, disclosing the nature of the compensation arrangement or any other business or financial relationships that exist with an entity 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 adequate levels of public disclosure and transparency a priority for their ESG ratings and data products, including their methodologies and processes to enable the users of the product to understand what the product is and how it is produced, including any potential conflicts of interest and while maintaining a balance with respect to proprietary or confidential information, data and methodologies.

- ESG ratings and data products providers could consider:
 - o making public disclosure and transparency a priority for their ESG ratings and data product offerings, subject to commercial sensitivity considerations.
 - o clearly labeling their ESG ratings and data products to enable the user to understand the ESG rating's or ESG data product's intended purpose including its measurement objective.
 - o 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.
 - o 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 could consider publishing include, but is not limited to:
 - o the measurement objective of the ESG rating or data product;
 - o the criteria used to assess the entity or company;
 - o the KPIs used to assess the entity against each criterion
 - o the relative weighting of these criteria to that assessment;
 - o the scope of business activities and group entities included in the assessment;
 - o the principal sources of qualitative and quantitative information used in the assessment as well as information on how the absence of information was treated;
 - o the time horizon of the assessment; and
 - o the meaning of each assessment category (where applicable).

Recommendation 6: ESG ratings and data products providers could consider adopting and implementing written policies and procedures designed to address and protect all non-public information received from or communicated to them by any entity, or its agents, related to their ESG ratings and data products, in a manner appropriate in the circumstances.

- ESG ratings and data products providers could consider :
 - adopting and implementing written policies and procedures and mechanisms related to their ESG ratings and data products designed to address and protect the non-public nature of information shared with them by entities under the terms of a confidentiality agreement or otherwise under a mutual understanding that the information is shared confidentially.
 - adopting and implementing written policies and procedures designed to address the use of non-public information only for purposes related to their ESG ratings and data products or otherwise in accordance with their confidentiality arrangements with the entity.
 - including information on data confidentiality management and on the protection of non-public information to the extent terms of engagement are published.

5.3 Recommendations for market participant 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 and consultation responses. 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 provide recommendations that promote the adoption of written policies and procedures designed to address the conduct of due diligence, or information gathering and review, and governance to help ensure mechanistic reliance on ESG ratings and data products is avoided where at all possible.

Recommendation 7: Market participants could consider conducting due diligence, or gathering and reviewing information on the ESG ratings and data products that they use in their internal processes. This due diligence or information gathering and review 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.

- Market participants could 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, including if they are science-based, quantitative, verifiable, and aligned with existing standards and taxonomies, 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

- o a determination as to the internal processes of the financial market participant for which the product is suitable.

5.4 Recommendations on how ESG ratings and data products providers could consider interacting with entities subject to assessment

IOSCO has drawn on feedback received during the fact-finding exercise and the consultation process to provide recommendations that providers could consider to help address some of the reported shortcomings with respect to interactions with entities covered by ESG ratings and data products. For ESG rating and data providers this means providing greater forward visibility to covered entities as to what to expect from their assessment processes. An example of how this can be addressed could be the introduction of “Terms of Engagement” that are agreed upon between ESG ratings and data product providers and the covered entities. These terms of engagement could provide covered entities with visibility on the assessment process, when data is likely to be requested and how it will be treated by the ESG rating and data provider.

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

Recommendation 9: Where feasible and appropriate, 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.

- Where they collect information from covered entities on a bilateral basis, ESG ratings and data products providers could consider:
 - o communicating sufficiently in advance when they expect to request this information regarding their ESG ratings and data products.
 - o 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 could consider:
 - o 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.
 - o 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.
 - o allowing the covered entity time to draw attention to any factual errors in the product, including the data and information underlying the product.

- publishing terms of engagement describing how and when the ESG rating and data providers will typically engage with their covered entities, including when information is likely to be requested and the opportunities available to the covered entity for review.

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

The final part of IOSCO's 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 recommends 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 making sustainability information public and consolidating it 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.²⁸

As discussed in greater detail in the Introduction to this report, IOSCO, through WS1, has engaged with the IFRS Foundation as the IFRS Foundation has worked towards the establishment of an ISSB. IOSCO considers that the newly launched ISSB can 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 frameworks. These efforts by WS1 are intended to drive much-needed international consistency and comparability in sustainability-related information. In turn, this information could become an essential part of any methodology underpinning the development of ESG ratings or data products.²⁹

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 jurisdictions' applicable regulatory and other legal requirements.

- Entities subject to assessment by ESG ratings and data products providers could 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.

²⁸ The STF Workstream 1 report can be accessed at the following link:
<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD678.pdf>

²⁹ The STF Workstream 1 report can be accessed at the following link:
<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD678.pdf>

- o 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.
- o designating a dedicated point of contact to address any requests from or queries to ESG ratings and data products providers that provide coverage for that entity.

Annex 1: 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 and public consultation, 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. Certain Financial Benchmarks with an ESG or climatic focus may be captured by the spirit of the below terminology. Where the providers of these products are already applying IOSCO’s principles for Financial Benchmarks³⁰ the recommendations applicable to ESG rating and data providers should not be considered as relevant for those products. The basis for this being that the governance and quality of these benchmarks is already being assured by these existing principles.

Scoping Terminology – ESG Data Products and ESG Ratings
<i>“ESG data products”: refer to the broad spectrum of data products that are marketed as providing either a specific E, S, or G focus or a holistic ESG focus on an entity, financial instrument, product or company’s ESG profile or characteristics or exposure to ESG, climatic or environmental risks or impact on society and the environment, whether or not they are explicitly labelled as “ESG data products”.</i>
<i>“ESG ratings”: refer to the broad spectrum of ratings products that are marketed as providing an opinion regarding an entity a financial instrument or a product, a company’s ESG profile or characteristics or exposure to ESG, climatic or environmental risks or impact on society and the environment that are issued using a defined ranking system of rating categories, whether or not these are explicitly labelled as “ESG ratings”.</i>

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

³⁰ [FR 07/13 IOSCO Principles for Financial Benchmarks](#)

the practices of the providers, with individual views being set according to specific investment or measurement objectives and different expectations on sustainability practices.

Comments Provided by Stakeholders During IOSCO Fact-Finding Exercise
Term “ESG” has been defined by some market participants, although this was a minority of cases. <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>
Other more ad-hoc judgements for “ESG” in place where this is not present. <i>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:</i> <i>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.</i>

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 2: Final IOSCO Recommendations

Recommendation 1: Regulators could consider focusing more attention on the use of ESG ratings and data products and ESG ratings and data products providers that may be subject to their jurisdiction.

Recommendation 2: ESG ratings and data products providers could consider adopting and implementing written procedures designed to help ensure the issuance of 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.

Recommendation 3: ESG ratings and data products providers could consider adopting and implementing written policies and procedures designed to help ensure their decisions are independent, free from political or economic interference, and appropriately address potential conflicts of interest that may arise from, among other things, 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 and their officers and employees.

Recommendation 4: ESG ratings and data products providers could consider identifying, avoiding or appropriately managing, mitigating and disclosing potential conflicts of interest that may compromise the independence and objectivity of the ESG ratings and ESG data products provider's operations.

Recommendation 5: ESG ratings and data products providers could consider making adequate levels of public disclosure and transparency a priority for their ESG ratings and data products, including their methodologies and processes to enable the users of the product to understand what the product is and how it is produced, including any potential conflicts of interest and while maintaining a balance with respect to proprietary or confidential information, data and methodologies.

Recommendation 6: ESG ratings and data products providers could consider adopting and implementing written policies and procedures designed to address and protect all non-public information received from or communicated to them by any entity, or its agents, related to their ESG ratings and data products, in a manner appropriate in the circumstances.

Recommendation 7: Market participants could consider conducting due diligence or gathering and reviewing information on the ESG ratings and data products that they use in their internal processes. This due diligence or information gathering and review 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.

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

Recommendation 9: Where feasible and appropriate, 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.

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 jurisdictions' applicable regulatory and other legal requirements.

Annex 3: WS3 Consultation Report Feedback

Feedback was submitted by the following three (3) individuals and fifty-eight (58) organisations to the Consultation Report.

Individuals

1. Robin Whitecross
2. William J. Harrington
3. William Michael Cunningham

Organisations

1. 2percent
2. AIMA
3. AKFI: Actionable Knowledge Foundational Institute
4. Allan Gray
5. Allianz Global Investors
6. Apex ESG Rating Ltd
7. Asset Management Group of the Securities Industry and Financial Markets Association (“SIFMA AMG”)
8. Association of Real Estate Fund
9. Austrian Association of Investment Fund Management Companies
10. Austrian Federal Economic Chamber
11. AXA Investment Managers
12. Bloomberg L.P.
13. BVI
14. CaixaBank
15. CDP
16. Chartered Professional Accountants of Canada
17. CHFT Advisory and Appraisal
18. CRISIL Ratings Limited
19. Deloitte Touche Tohmatsu Limited
20. Deutsche Börse Group
21. EcoVadis
22. EFAMA
23. Euronext
24. Eurosif
25. FICC Markets Standards Board (FMSB)
26. Finance Denmark
27. First Nations Financial Management Board.
28. Fitch Ratings
29. Friends of the Earth (HK)
30. Global Financial Markets Association (GFMA)

31. Global Legal Entity Identifier Foundation (GLEIF)
32. Hermes Fund Managers Limited
33. ICE Data Services
34. IHS Markit
35. Institute of International Finance
36. Institutional Shareholder Services Inc.
37. International Regulatory Strategy Group
38. Investment Company Institute
39. ISO CCCC and ISO TC68
40. Japanese Bankers Association
41. LSEG
42. Mirova
43. Moody's ESG Solutions Group
44. Morningstar
45. MSCI
46. Principles for Responsible Investment's (PRI)
47. RAEX-Europe
48. S&P Global
49. SEC Thailand
50. Stichting Onderzoek Multinationale Ondernemingen (SOMO)
51. Superintendent of the Securities Market of Panama
52. The Brazilian Institute of Corporate Governance
53. The Investment Association
54. The World Federation of Exchanges
55. UK Finance
56. World Bank
57. World Business Council for Sustainable Development
58. Worldwide fund for Nature

The IOSCO Board is grateful for the responses and has taken them into consideration when preparing this final report. The rest of this section summarises the replies received to the proposed recommendations and consultation questions. Overall, respondents were supportive of IOSCO's work and were broadly in agreement with the proposed recommendations set out in the Consultation Report; although they provided further suggestions to the underlying text explaining how the recommendations could practically be implemented.

Proposed Recommendations for IOSCO and IOSCO Members concerning ESG ratings and data products (Recommendation 1) as set out in the Consultation Report.

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.

Most of the respondents were supportive of this recommendation and encouraged the development of regulatory framework or code for ESG ratings and data product providers.
--

There was overall agreement over the fact that such a framework should contain elements such as the avoidance of conflicts of interest, transparency on underlying methodologies and associated data collection disclosures, with some suggesting it should also consider the introduction of standardised definitions for the terminology used and referred to by ESG rating and data products.

A few respondents suggested that any framework contemplated for ESG ratings and data products providers needs to be proportionate and remain fundamentally principles-based in nature as not to stifle market innovation. As such, they noted IOSCO's approach should not be overly prescriptive and asked the action points either be deleted or clarified as voluntary in nature. A couple of respondents also suggested making a more linear distinction between recommendations – and the guidance underpinning them – that would apply to ESG ratings providers and those which could apply to ESG data product providers.

IOSCO's response: IOSCO welcomes respondents' support for the view that a regulatory framework should exist for ESG ratings and data product providers. We added a description of the action points, now referring to them as guidance on policies and procedures, and clarifying that they are provided as helpful guidance that may need to be updated as the ESG industry evolves. While IOSCO agrees the way some of the recommendations applies to ESG ratings and data product providers may at times need to differ to account for their underlying business models, the philosophy contained within each high-level recommendation is sufficiently proportionate to apply to both. Where applicable, we will make distinctions or provide examples in the guidance that underpins those recommendations.

Proposed Recommendations for ESG ratings and data products providers (Recommendations 2-6) as set out in the Consultation Report.

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.

Most respondents were supportive of the proposed recommendation. Some respondents pointed out that regulatory efforts focused on greater standardisation of ESG and climate disclosure would contribute in improving the quality of underlying inputs that go into ESG and sustainability ratings, assessments, and scores. However, they also noted the need to be proportionate in the implementation of this recommendation, suggesting it may not always be appropriate to provide data sources where these stem from proprietary information. A number of commenters raised a concern that there was a call for standardized methodologies, consistent across the industry, which could be detrimental in the developing ESG market.

In respect of validation, some respondents mentioned that, statistical validation can be difficult and the recommendation should instead focus on promoting the publication of ESG performance reviews by the provider. On the element of 'sufficient resources to carry out high-quality ESG-related assessments', one respondent proposed spelling out that there should be sufficient resources for quality assurance of ratings provided.

IOSCO's response: IOSCO welcomes respondents' overall support for the recommendation. We take on board comments about the need to be balanced in expectations on transparency and have made some minor amendments to the underlying guidance. We have added an explicit note that the focus is on transparency and internal consistency. As such, there is no call for standardized methodologies, consistent across the industry.

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.

Most respondents backed these recommendations, but suggested IOSCO should also consider disclosure of these potential conflicts of interest as part of the recommendations. One respondent specifically highlighted the need to be totally independent and free from any political or economic pressures in addition to other potential conflicts of interest.

IOSCO's response: IOSCO has slightly modified the wording of recommendation four to clarify its intent. We do not believe any further changes need to be made.

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.

Most respondents agreed that transparency in methodologies is important, noting this would contribute in enhancing the comparability and reliability of ESG ratings and data products. One respondent suggested that a minimum level of disclosure could include reference to the relevant methodology used, where to find the methodology and any relevant supporting documents, a list of relevant data sets or information used to create the product, the provider's governance process for the product, whether the product is based on any information that is not public, the terms and conditions of the product's use, any potential conflicts of interest, and – in the case of an ESG rating product – whether the rating was solicited and / or paid for by the subject entity.

Without going into the same level of detail, many respondents indicated that information disclosed by rating agencies should be of sufficient quality to allow stakeholders to have a reasonable sense of what the rating was intending to measure and how they approached this measurement. They however suggested a balance needs to be struck between what information ESG ratings and data products providers are willing to publish, given the commercial proprietary nature of methodologies, and the usefulness of that information.

IOSCO's response: IOSCO has made some amendments to the recommendation, to clarify that disclosures should be sufficiently detailed to enable the users of the product to understand what the product is and how it is produced, including any potential conflicts of interest. Within the

guidance, we also encourage ESG ratings and data product providers to be transparent about how and when they will typically engage with a rated entity. We also added a note that there should be a balance between disclosure of methodologies and data, and preservation of proprietary or confidential information.

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.

The majority of respondents supported this recommendation, with some however noting that data reliability was an issue as it was not always possible to verify the information received. Generally, it was suggested that the solicitation of price-sensitive, non-public information should not be encouraged. Where non-public information was shared, the ESG ratings or data product provider should share information on data confidentiality management and on the protection of non-public information.

IOSCO's response: We welcome respondents' support for the recommendations and agree that, where non-public information is shared; the provider should have, and be transparent about, data confidentiality arrangements in place. We have amended the underlying guidance to account for this point. We also note that, in some jurisdictions, it is impermissible for public issuers to selectively disclose material non-public information and issuers and ESG ratings firms or data providers should bear in mind such restrictions.

Proposed Recommendation for users of ESG ratings and data products (Recommendation 7) as set out in the Consultation Report.

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.

The majority of respondents welcomed this recommendation, suggesting due diligence should be a key aspect of investment decision making for any investors that use these products as part of their processes. Some suggested due diligence should include a process for the treatment of new information and quality control checks, data quality of the filtered information, classification procedures of the information, methodologies, human capital management policies and performance regarding talent attraction and retention of ESG experience and expertise and certifications and or additional assurance, including systems testing.

IOSCO's response: IOSCO welcomes respondents' support for the recommendation. We do not however propose, at this stage, to go into the level of detail proposed by some respondents with regard to due diligence; noting that existing regulatory frameworks may already cover some of these aspects.

Proposed Recommendation on how ESG ratings and data products providers could consider interacting with entities subject to assessment (Recommendations 8-9) as set out in the Consultation Report.

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

Most respondents were in favour of these recommendations. They emphasised the significance of the interaction between companies and rating providers in obtaining reliable data. They pointed out that it is the more efficient and effective way to assess an organisation's ESG performance and encouraged companies to provide a point of contact to address any requests from or queries to ESG ratings and data product providers. However, respondents wished to make it clear this should not be a way for covered entities to influence the outcome of the rating.

IOSCO's response: We welcome respondents' feedback and will not make any changes to the recommendations, with the exception of noting that recommendation 9 should be met "to the extent feasible".

Proposed Recommendation on how covered entities could consider interacting with ESG ratings and data products providers (Recommendation 10) as set out in the Consultation Report.

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.

Most of the respondents were of the view that the standardisation of minimum disclosure at company-level would be beneficial and allow for greater comparability. They suggested entities could be asked to fill in one master questionnaire for all ESG ratings and data products providers on a periodic basis. Several respondents noted the overlap with WS1 and IFRS and TCFD work on ESG disclosures.

IOSCO's response: We will keep the recommendation as it is based on feedback by respondents, and have added a more explicit reference to the work and report of WS1 with respect to this recommendation.