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

UK Finance response to IOSCO consultation

6 September 2021

Overview

UK Finance is the collective voice for the banking and finance industry operating within the UK. Representing around 300 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation.

Sustainability is one of our six strategic priorities. We are wholly supportive of the UK's goal to achieve net zero emissions by 2050, as well as the interim targets set out in the carbon budgets, and recognise the important role for the banking and finance sector in this historic transition. Our Board in May passed a resolution expressing support in principle for the global Net Zero Banking Alliance (NZBA), formed as part of the Glasgow Financial Alliance for Net Zero (GFANZ) announced only the month before, and encouraging all members to embed climate responsibility into their governance and strategy in support of whole economy transition to net zero by 2050 premised upon *just transition* principles.

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

1.1 Please provide details of your views on ESG ratings from a general perspective. In providing your answer, please outline your experiences of using and integrating ESG ratings within your internal processes, your interactions with ESG ratings providers and the aspects of these products you find most useful as well as those that cause the most difficulty.

- ESG ratings are a useful data source for stakeholders to understand a firm's approach to ESG. As rated entities, our members use the methodologies of numerous ESG ratings to support the development of their public disclosures.
- Members have told us that engagement with ESG ratings providers is varied. Some providers provide slick systems for easy engagement and endeavour to respond within a set time frame, whilst others can be more difficult to communicate with.
- The identification of 'key issues' for different industries is clear and appropriate, however, current ESG ratings models/methodologies do not account for specifics within subindustries. This often results in inaccurate information being shared and unfair penalties on firms whose business does not align to the set methodology. For example:
    - Receiving a negative score for not being a signatory to certain initiatives even when not relevant to a particular business (equator principles / PRI etc.)
    - Penalties for dispersed ownership/lack of stock rewards for mutual/cooperatives
    - Penalties for lack of policies in business lines the firm is not engaged in

1.2 Please provide your views on ESG data from a general perspective. In providing your answer, please outline your experiences around ESG data and integrating ESG data products within your *internal processes, your interactions with ESG data providers and the aspects of these products you find most useful and those that cause the most difficulty.*

- Our members have commented that ESG data is often a better source of information for ESG analysis given its less subjective nature. ESG data allows entities to build better proprietary models focussing on the ESG matters that they care most about.
- The ongoing work to develop standardised ESG disclosures should support and further strengthen the credibility of ESG data providers.
- Our members would encourage greater proactive engagement from ESG data providers. This would enable the providers to be directed to the relevant public disclosures, which should result in more reliable outputs from the data providers, resulting in users of the data being able to better embed ESG within their oversight / decision-making process.

1.5 Please provide your views as to whether IOSCO has a role to play in the area of ESG ratings and ESG data providers and, if so, what you consider that role might be.

- Yes, IOSCO's relationship with global regulators puts the organisation in a unique position to work with and influence regulators to increase the levels of oversight on ESG ratings and data providers, resulting in a fairer market for all.

Development of ESG Industry

1.14 Do you consider the variations between the ESG rating products that are currently available in the market to be a positive or a negative feature of the market? In providing your answer, please outline what steps you consider should be taken to enhance or correct this feature of the market. If possible, please support your answer with reference to the specific practices of ESG rating and data providers that should be addressed.

- There are positives and negatives as a result of the variations in the market.
    - The variation in methodologies and weightings allow investors to pick services that are more heavily weighted for ESG matters that they care about.
    - However, it isn't helpful that the bar of what good looks like isn't consistent across the industry. There are some topics where some members score well with one rating agency but score poorly with another. It is not clear why this is the case. It would be helpful for agencies to be more transparent on what they deem to be good disclosures, and for methodologies to be somewhat aligned to standardised global standards.

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

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

> 1 - There would be no differentiation of ratings amongst agencies and as ESG isn't explicitly defined and it is open for interpretation this would not be appropriate or fit for purpose for the users of the ratings.

ii. The disclosures applicable to ESG rating methodologies;

> 5 – If ESG rating methodologies were published it would be much easier for issuers and investors to understand what disclosures are necessary and why firms may score better or worse than expected.

iii. The disclosures applicable to ESG ratings themselves;

3 – It would be helpful to understand what disclosures are expected for ESG rating agencies.

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

5 – All rated entities should be rated on a fair and equal basis.

v. The supervision of ESG rating products.

5 – A regulated market would be beneficial and fair for all market participants.

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

Given IOSCOs relationship with global regulators, IOSCO is in a unique position to bring regulators together and drive more standardised approach to ESG ratings oversight.

If you have any questions relating to this response, please contact paul.chisnall@ukfinance.org.uk

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