

COMMENT LETTER

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ICI Submits Response to IOSCO Questionnaire on ESG Ratings and Data Providers (pdf)

26 Feb 2021 1 ICI Global response to IOSCO's Sustainability Task Force Questionnaire on the uses, users, and providers of ESG ratings and ESG data products ICI Global carries out the international work of the Investment Company Institute (ICI), the leading association representing regulated funds globally. ICI's membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of US\$36.8 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Brussels, Hong Kong, and Washington, DC. ICI's members are important users of ESG ratings and ESG data, and we appreciate the opportunity to respond to this questionnaire. We were not able to provide as comprehensive a response as we would like given the short deadline, and we hope to be able to engage further with IOSCO on this important issue. Our responses are highlighted in yellow below. Survey questions and draft responses 1.1. Please provide details of your views on ESG ratings¹ 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. We appreciate IOSCO's differentiation between ESG data and ESG ratings. A service provider's ESG rating of a corporate issuer represents that provider's assessment of the company's ESG profile or performance based on ESG data. Regulators should not assume that all asset managers use ESG ratings, and we strongly urge against any regulatory requirement for asset managers to use ESG ratings. Asset managers may use ESG ratings as a research input in the investment process, similar to other research inputs. Legally mandating use of ESG ratings, however, is tantamount to requiring managers to purchase ratings from providers, even though ESG ratings vary significantly across providers given that they use different data inputs, obtain the underlying data from different sources, make different assumptions, and use different methodologies. Our members experience difficulty with a lack of transparency around several aspects of ESG ratings as follows: □ Scope of the data used – which indicators the provider is using to construct the rating. 1 The IOSCO Questionnaire defines "ESG ratings" as referring to the broad spectrum of rating products in the sustainable finance area that are marketed as providing an assessment of an entity or issuers ESG profile, characteristics or exposure to ESG, climatic or environmental risks, whether or not they are explicitly labelled as "ESG ratings". 26 Feb 2021 2 □ Methodology – how the underlying indicators are measured. □ Weighting of indicators – how the underlying indicators are weighted. □

Materiality considerations – what ESG considerations the service provider considers to be material for any particular company and how that determination is made. □ Timing of collection – how and when the service provider collects the underlying ESG data inputs. □ Frequency of review or update of the ESG rating. □ Timeframe of the underlying data inputs – whether the rating is based on last year’s data, an average of the past 5 years, backward-looking or forward-looking, etc. □ Access to raw data – our members would like better access to the raw data underpinning an ESG rating. □ Potential conflicts of interest – for example, some providers also have consulting or certification business, such as certification of green bonds issues by companies that they may be rating, or may provide corporate consulting on improving ESG scores. We note that lack of data from corporate issuers exacerbates ESG data quality issues, which in turn affects the quality of ESG ratings that are based on ESG data inputs. We separately urge IOSCO to consider corporate issuer disclosure of ESG information, which would provide a more consistent, comparable, reliable source of ESG data. Although this is not a definitive solution for addressing the above issues, we do believe that improving the availability and quality of company disclosure of ESG information would in turn improve the availability and quality of the ESG data that underpins ESG ratings. We also note that asset managers’ expenditures on ESG data and ratings have significantly increased over the last couple years and are continuing to sharply increase. Increases in the cost of ESG data and ratings, in turn increase the cost of providing ESG investing strategies to investors.

1.2. Please provide your views on ESG data² 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. Asset managers use ESG data about investee companies and investments in many different ways, including: □ For investing – for example, as a research input in the investment process, a risk management tool, a component in an ESG-related investment strategy, or to inform stewardship and engagement with investee companies; 2 The IOSCO Questionnaire defines “ESG data” as referring to the broad spectrum of data products in the sustainable finance area that are marketed as providing information on an entity, issuer or industries’ ESG profile, characteristics or exposure to ESG, climatic or environmental risks, whether or not they are explicitly labelled as “ESG data”. 26 Feb 2021 3 □ For client reporting; and □ For regulatory purposes – for example, to comply with ESG-related disclosure requirements (e.g., the EU Sustainable Finance Disclosure Regulation). Asset managers experience many difficulties with ESG data quality and availability as follows: □ Lack of accuracy, reliability, and comparability. □ Lack of coverage depending on asset class, geography, size of company, and many other factors. □ Lack of sector-specific information. In addition to issues with the quality and availability of ESG data, asset managers experience difficulties with ESG data from service providers as follows: □ Methodology – lack of transparency into how an indicator is measured. □ Materiality considerations – lack of transparency into what ESG considerations the service provider considers to be material for any particular company and how that determination is made. □ Source of data – providers may obtain information from sources such as regulatory databases where companies are required to file reports of incidents or organizations that research and compile information on companies/countries such as fatalities or OECD data to determine risk exposures of countries. □ Estimated or modeled data – service providers may estimate or model data, using different inputs, assumptions, and methodology. It is not always clear when service providers are estimating or modeling ESG data vs. obtaining the data directly from a company or another source. □ Timing of collection – lack of transparency into how and when the service provider collects the underlying ESG data inputs. □ Frequency of review or update of the data. □ Significant cost of ESG data, particularly to comply with new EU regulatory requirements that mandate

disclosure of ESG data across all investments – disclosure of ESG data involves obtaining data from investee companies and/or data providers, developing in-house analytical capabilities, implementing new systems to track data indicators across aggregate investments, among other elements. Asset managers' expenditures on ESG data and ratings have significantly increased over the last couple years and are continuing to sharply increase. One of the ESG data-related areas our members find most challenging is regulatory requirements to disclose ESG data that is not broadly available from investee companies globally. For example, the EU Sustainable Finance Disclosure Regulation (SFDR) will soon require asset managers to disclose ESG data on investments even though that data is not yet widely available from investee companies or across all asset classes. We also note that the EU Taxonomy Regulation's new disclosure requirements similarly will require asset managers to obtain significant amounts of data from investee companies globally— data that is not currently available, even in the EU. 26 Feb 2021 4 Although the EU aims to require some corporate issuers to disclose this data (in the upcoming review of the Non-Financial Reporting Directive or NFRD), the lack of data availability will not be resolved before the SFDR or Taxonomy compliance dates. Even if this data was available from every company in the EU, asset managers are required to disclose this data for investments outside of the EU as well. We note that lack of data from corporate issuers exacerbates many of the ESG data quality and availability issues described above. We separately urge IOSCO to consider corporate issuer disclosure of ESG information, which would provide a more consistent, comparable, reliable source of ESG data. Although this is not a definitive solution for addressing the above issues, we do believe that improving the availability and quality of company disclosure of ESG information would in turn improve the availability and quality of ESG data.

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. As stated in our response to Question 1.1, regulators should not assume that all asset managers use ESG ratings, and we strongly urge against any regulatory requirement for asset managers to use ESG ratings. Asset managers may use ESG ratings as a research input in the investment process, similar to other research inputs. Legally mandating use of ESG ratings, however, is tantamount to requiring managers to purchase ratings from providers, even though ESG ratings vary significantly across providers given that they use different data inputs, obtain the underlying data from different sources, make different assumptions, and use different methodologies. As discussed in our response to Question 1.2, ESG data availability, quality, and cost present significant and ongoing challenges with respect to new regulatory requirements around asset manager and fund disclosure of ESG data.

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. Variations in ESG ratings are generally due to differences in scope (what indicators are included), measurement (what methodologies are used to measure each indicator), and the weighting of individual indicators. For example, different providers may have different views about the set of relevant indicators that should be considered in an ESG rating, and their ratings would vary accordingly. As discussed in our response to Question 1.1, asset managers need more transparency into the basis for providers' ESG ratings—including scope, measurement, methodology, and other elements. Increased transparency additionally will allow asset managers to better understand why one provider's ESG rating of a company differs from another provider.

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