SustainAbility
an ERM Group company

Rate the Raters 2020:

Investor Survey and Interview Results

March 2020

About this Report

SustainAbility, an ERM Group company, is a think tank and advisory firm that works to inspire and enable business to lead the way to a sustainable economy. Our agenda-shaping research challenges individuals, companies and industries to transform the ways they think and do business, and explains how to make lasting change. All SustainAbility research reports are publicly available at sustainability.com.

Rate the Raters Research Series

In 2010, SustainAbility undertook its first Rate the Raters project to better understand the environmental, social, and governance (ESG) ratings landscape and provide perspectives to help companies, investors and other stakeholders make sense of and derive more value from ESG ratings.

In 2017, SustainAbility revisited this topic in order to provide an updated view of stakeholder perspectives and shed light on how ESG ratings were being used, as well as to identify challenges and provide recommendations. Rate the Raters 2018: Ratings Revisited outlined themes that emerged from several roundtables and interviews with investors, companies and ratings research firms and explored why the topic merited new research. These roundtables informed the work conducted in 2019-2020 that culminates with this report.

Rate the Raters 2019–2020

The first report, Rate the Raters 2019: Expert Survey Results, focused on key insights from a survey of over 300 sustainability professionals in corporate, NGO, government, academic and other sectors. Phase two, this report, was designed to highlight the perspectives of investors. It shares insights from 17 in-depth interviews with investors, supplemented by a survey of 25 investors, highlighting their views on current ESG ratings and how they use these ratings to evaluate ESG topics. The report also includes specific recommendations for companies on how to approach the ESG ratings landscape in order to meet investor needs.

We hope that this research will spur further dialogue between investors, corporations and ESG research/rating firms to improve the ESG ecosystem for all stakeholders. We welcome your feedback and suggestions.

Acknowledgements

We express sincere thanks to our sponsors for their generous support; our interviewees and survey respondents; GlobeScan for distributing the survey; and, all of our SustainAbility, BrownFlynn, and other ERM Group colleagues and peers who generously contributed their time and insights to this report.

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Contents

Introduction 05

Objectives and Methodology 08

Key Findings 12

Investor Insights 16

- Top Sources of ESG Information 17
- ESG Ratings Use Frequency 18
- Number of ESG Ratings Used 19
- ESG Ratings Selection 19
- How Investors Use ESG Ratings 22
- Investor Critiques of ESG Ratings 28
- Investor Perceptions of Specific ESG Ratings 33

Investor Future Views and Expectations 41

Final Recommendations for Companies 46

Conclusion 48

Appendix 50

Introduction

A decade of ratings, growth and evolution

Since our original Rate the Raters research series launched in 2010 and concluded in 2013, the size, influence and complexity of the ESG ecosystem have all increased significantly. The number of ESG standards and frameworks, data providers, ratings and rankings has expanded, with 600+ ESG ratings and rankings existing globally as of 2018 and continuing to grow since. As this system has developed, it has influenced how companies report on and disclose ESG data and performance, shaped the creation of ESG-related investment products, and framed the public perception of companies. During this period, complexity has increased, as more traditional investment data providers, credit rating agencies and others have entered the ratings marketplace, driving merger and acquisition activity. Recent examples of this dynamism include Moody's acquisition of a majority stake in Vigeo Eiris[1] as well as S&P Global's purchase of the ESG business of RobecoSAM[2], including its well-known Corporate Sustainability Assessment (CSA), which underpins the Dow Jones Sustainability Index.

Drivers of ratings field dynamism

The rapid expansion of the ESG ecosystem has been driven in part by increased corporate reporting, which has generated reams of new – and better – ESG data. From 2011 to 2018, the proportion of S&P 500 companies reporting on their sustainability efforts, corporate social responsibility activities, and ESG performance increased from just under 20% to 86%[3]. At the same time, investors have been exploring pathways for ESG integration, reactively looking to better understand corporate ESG performance in order to better respond to client pressure, and proactively seeking means to apply ESG in ways that might improve investment decisions.

Indicative of this growth, the more than 2,300 signatories to the UN Principles for Responsible Investment (PRI), with over $80 trillion in collective assets under management (AUM), have committed to incorporating ESG issues into investment analysis and decision-making process[4]. Meanwhile, increasing stakeholder pressure was reflected in a 2019 Harvard Business Review (HBR) article[5] noting asset owners are facing growing demand from clients to ensure that their investments make a difference in the world. The HBR piece quoted Michael Baldinger, head of Sustainable and Impact Investment at UBS Asset Management, who said "The demand for ESG investment options is so high that many asset management firms are rushing to pull together new offerings. Sustainable and impact investment at UBS Asset Management has more than tripled since December 2016, with $17 billion in AUM."

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[1] *"Moody's Acquires Majority Stake in Vigeo Eiris, a Global Leader in ESG Assessments"*. **Businesswire. Web. April 2019.** www.businesswire.com/news/home/20190415005184/en/Moody%E2%80%99s-Acquires-Majority-Stake-Vigeo-Eiris-Global

[2] *"S&P Global to Acquire the ESG Ratings Business from RobecoSAM"*. **S&P Global. Web. November 2019.** www.spglobal.com/en/research-insights/articles/sp-global-to-acquire-the-esg-ratings-business-from-robecosam-shell

[3] *"86% of S&P 500 Index® Companies Publish Sustainability / Responsibility Reports in 2018"*. **Sustinability Reports. Web. May 2019.** www.sustainability-reports.com/86-of-sp-500-index-companies-publish-sustainability-responsibility-reports-in-2018/

[4] *"About PRI"*. **Principles for Responsible Investment. Web. 2019.** www.unpri.org/pri/about-the-pri

[5] *Robert G. Eccles and Svetlana Klimenko. "The Investor Revolution"*. **Harvard Business Review. May 2019.** hbr.org/2019/05/the-investor-revolution

Today's Challenge

In this shifting environment, we consistently hear from corporate practitioners and colleagues that they are encouraged by increased investor interest in ESG performance, but struggle with how to best allocate limited resources to ESG ratings data collection and reporting. Corporate management of ratings involves developing responses to active raters, like CDP or the RobecoSAM Corporate Sustainability Assessment (CSA). Active raters request information from companies in the form of a questionnaire or survey, aggregate the relevant information and provide a rating. Companies also need to verify the work of passive raters, organizations that pull ESG information from corporate reporting, evaluate the data and add a rating (often using a proprietary scoring methodology). Each company's management of ESG ratings can require hundreds of hours and multiple dedicated staff, which even large organizations may struggle to support. Small and mid-sized companies with fewer resources run the risk of not managing ESG ratings at all. In this situation, how can the growing number of investors interested in ESG get the information they want and need?

While keen to provide clear and useful ESG data and disclosure to investors, we find companies asking: How exactly are investors using our ESG data? How does that drive where companies should spend their limited time? Which ratings do investors use most, and how can that knowledge inform where companies focus? These core questions formed the foundation for this most recent Rate the Raters report, the results of which we are pleased to present in the sections that follow.

ESG Merger and Acquisition Activity

Significant interest among traditional investment research firms and ESG speciality shops

Feb 2009
Riskmetrics Group buys innovest

Sep 2009
Sustainalytics and Jantzi Research Inc. merge

Nov 2009
Thomson Reuters buys Asset 4

RiskMetrics Group buys KLD

Dec 2009
Bloomberg buys New Energy Finance

Mar 2010
MSCI buys RiskMetrics Group

Jul 2010
GMI and The Corporate Library merge

Jun 2012
Sustainalytics acquires Responsible Research

Jun 2014
MSCI acquires GMI Ratings

Sep 2015
ISS acquires Ethix SRI Advisors

Oct 2015
Vigeo and EIRIS merge

Oct 2016
Standard & Poor's buys Trucost

Jan 2017
ISS buys IW Financial

Jun 2017
ISS acquires South Pole Group's Investment Climate Data Division

Jul 2017
Morningstar buys 40% of Sustainalytics

Mar 2018
Sustainalytics buys certain assets from Solaron Sustainability Services

ISS acquires Oekom Research

Jan 2019
Sustainalytics acquires GES International

Apr 2019
Moody's acquires a majority stake in European ESG ratings firm Vigeo Eiris

Jul 2019
Moody's acquires a majority stake in climate data firm Four Twenty Seven

Sep 2019
MSCI acquires environmental fintech and data analytics firm Carbon Delta

Oct 2019
Thomson Reuters acquires FC Business Intelligence, the parent company of Ethical Corporation

Dec 2019
RobecoSAM transfers SAM ESG ratings and Benchmarking to S&P Global

Objectives and Methodology

Objectives

This report is designed to help companies understand when, where, and how investors are using ESG ratings to best leverage growing investor interest in ESG. The primary research objectives were to:

1. **Shed light on how investors are using ESG ratings: which ratings, how often, and in what way.**

2. **Obtain an updated view of investor perspectives on ESG ratings to compare to the results from the Rate the Raters 2019: Expert Survey Results.**

3. **Identify challenges in the ESG ratings ecosystem and provide recommendations on how to more effectively navigate the landscape.**

Methodology

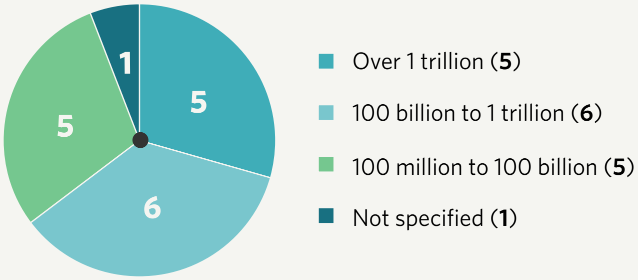
The research focused on two elements: a survey and interviews. A variety of investors were engaged across both survey and interviews incorporating a range of geographies, investor types (pension funds, asset managers, banks), investment approaches (including active and passive), and levels of ESG integration. At several points, the robust research completed by SRI-Connect and Extel's annual Independent Research in Responsible Investment (IRRI) survey was used to supplement the findings.

While robust, the perspectives gleaned from the interviews and survey are not indicative of all investor approaches and perspectives. Companies should always actively engage with their top investors in order to understand how they approach ESG, which issues they believe are critical for the company to manage and report, and how they want to engage with these issues.

Interviews

Staff from 17 investment firms split evenly across North America and Europe were interviewed to gain an understanding of why and how they use ESG data, which research firms they use, and trends they see in the space. Interviewees represented a variety of positions including analysts, senior portfolio managers and heads of sustainable investment research to gain a breadth of viewpoints on company approaches, structures and mechanisms to ESG ratings and analyses. All quotes throughout the report are anonymized.

Asset Size USD



Firms Interviewed

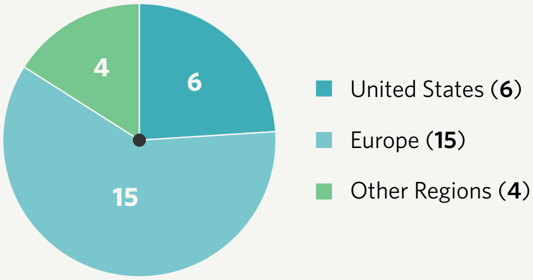
1. AGF
2. Arabasque
3. Generation Investment Management
4. Glitterman Wealth Management
5. Hermes
6. JP Morgan Chase
7. Manulife
8. NN Investment Partners
9. Schroders
10. Skagen
11. Storebrand
12. UBS
13. WHEB Asset Management

Plus four other anonymous investors.

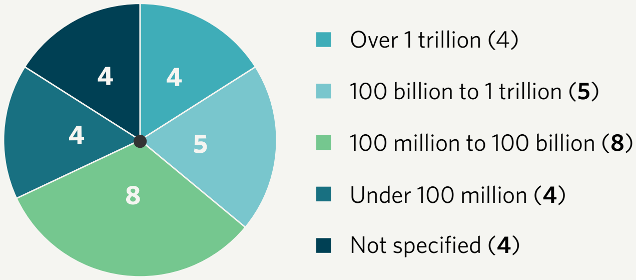
Survey

More than 500 investors were surveyed from December 2018–May 2019, with 25 respondents. While the investor survey response rate (n=25) was not nearly as robust as that from the 2019 Phase 1 expert survey (n=319), we still offer comparisons between these results throughout this report. We recommend readers consider the moderate sample size of Phase 2 from which conclusions are drawn in this report.

Region



Asset Size USD



Definitions

Investors:

Refers to both survey respondents and interviewees unless specifically noted. The investors surveyed and interviewed represent a variety of investor types including asset managers, retail, pension funds, hedge funds, endowments insurance and investment advisory.

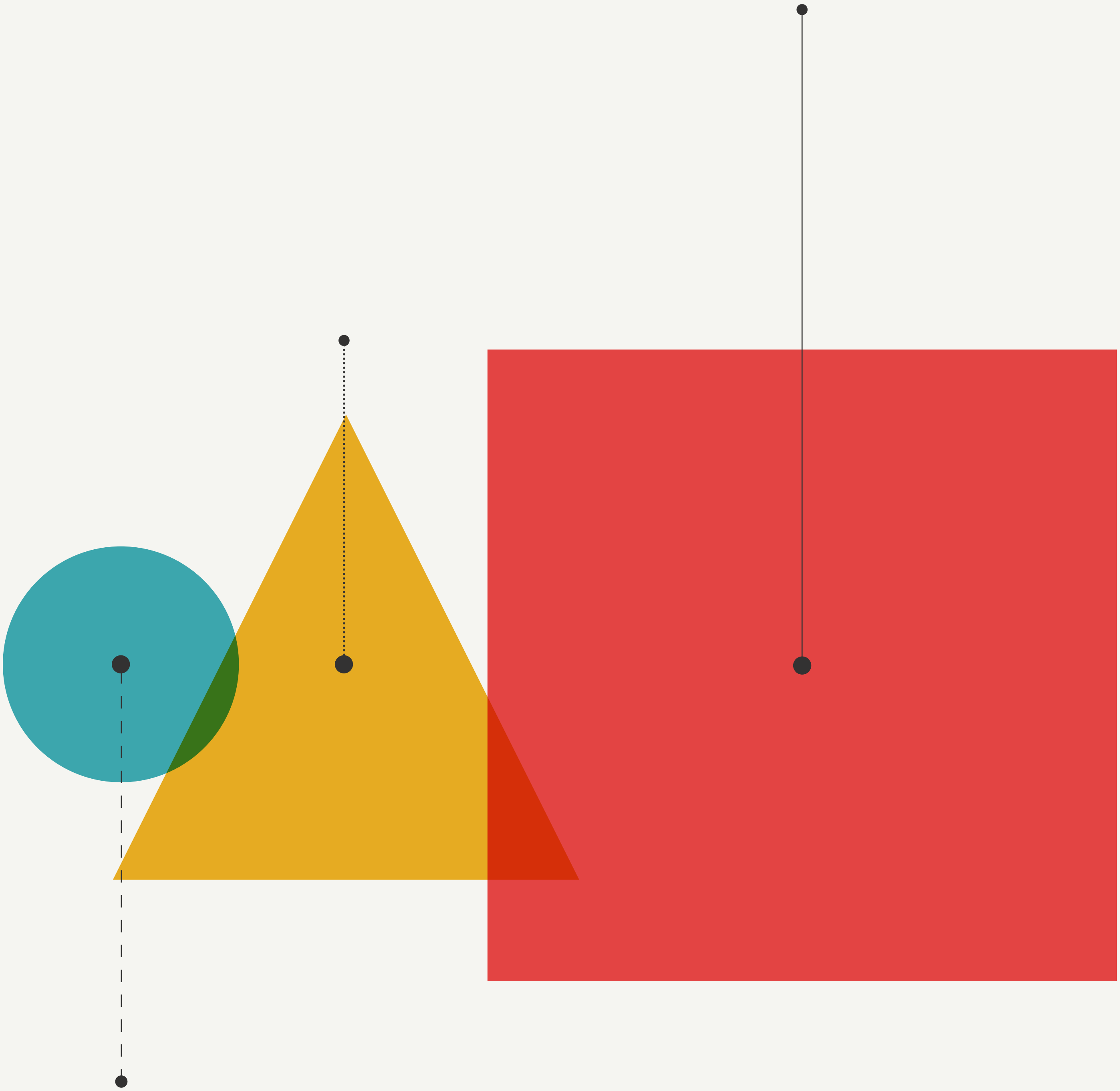
ESG ratings:

The evaluations of a company based on a comparative assessment of their quality, standard or performance on environmental, social or governance (ESG) issues.

ESG rankings:

Lists that classify companies based on their performance and put them in a certain order or grouping based on a specified grading system. Due to scope limitations, ESG rankings are excluded from this research.

Key Findings



Key Findings

The results of the 2019 work behind this report were amazingly numerous, deep and diverse. While near impossible to quickly summarize, these key findings present a snapshot of the elements we found to be most interesting and most useful.

Investors and asset managers approach ESG differently: A remarkable range of ESG integration techniques exists across investment/asset management firms. Some have fully embedded ESG, while others are just starting to apply it, at times relatively ad hoc. These differences in approach impact both how firms use ESG ratings (for example, firms with fewer internal resources and less ESG expertise rely more heavily on ratings) and how they engage companies. Although we predict more and more investors and asset managers will move towards full ESG integration in the future, we expect that transition will take at least several years.

ESG ratings are used regularly by many investors – but evaluated differently by each: Investors point to corporate ESG ratings, direct engagement with companies, in-house research and corporate sustainability reports as the most useful sources of ESG information, with the majority using ESG ratings at least once a week. They frequently use more than one rating, preferring to access as much research as possible, and they regularly evaluate which ratings they use. The factors most important to ESG rating selection include: the number of companies a rating covers, quality and disclosure of rating methodology, focus on material issues, the credibility of data sources, and the experience of the research team.

ESG ratings are but one input among many: We assumed at least some investors would use ratings to directly inform investment decisions, but most investors we interviewed were more sophisticated in their thinking and approaches. They often use the data but explicitly not the scores from a rating to inform their own internal research, KPIs or scoring methodologies, and then establish their own view on a company's performance. In this way, ESG ratings are a starting point to understand the landscape and to benchmark companies against each other, or a poor rating may signal the need to do further research. Many investors interviewed for this report commented that investors often use ratings to screen or exclude poorly rated firms from ESG investment products or portfolios.

The business model matters: Several investors described thinking beyond operational performance, asking not just how a company manages ESG issues, but also seeking evidence that its business model is sustainable. While some of the more tenured impact investing firms have been thinking this way for years, our 2019 research found such considerations widespread, with many thoughtfully considering how a company's net activities benefit or hurt society and then applying that thinking to portfolio creation.

Ratings challenge and sometimes frustrate investors: Investors interviewed expressed strong critiques of ratings, from inaccuracies and use of old or backwards-looking data, to more fundamental concerns about whether ESG performance can ever be distilled into a single score. Investors also complained about holes in corporate data and the need for companies to improve disclosure, reporting and transparency. Almost all the investors we engaged believe that their own research analysts know better than ESG rating analysts, often because ratings research teams don't have as much experience and are spread too thin. Interestingly, many investors expressed concern that their peers may be hiding behind ratings as a quick fix or box-checking exercise, using them as a substitute for fundamental ESG research and analysis other investors do themselves. Investors perceive the reason such shortcuts are taken to be, at least in part, a rush to meet growing demand for ESG investment products, and point out that this risks quickly-created, poor quality products undermining demand longer-term.

ESG ratings have helped to mainstream sustainable investing: Regardless of frustrations with ESG ratings, few question the key role they have played in the integration of ESG issues and concepts into the investment lexicon. Ratings have promoted greater awareness of ESG issues while helping to educate the investment community and other stakeholders on how those issues are relevant to business. They have added credibility by formalizing ESG evaluation and analysis into packaged products, which have enabled further integration of sustainability topics. In spite of the warranted criticisms leveled at them, ESG ratings deserve recognition for helping drive sustainability towards the center of investment thinking and practice.

A smorgasbord of ESG ratings: Although Sustainalytics and MSCI were most often mentioned by investors, who favor them for their broad coverage, there is no single go-to rating for all investors. CDP and ISS were often mentioned for quality and usefulness, while ISS is praised most frequently for its governance scoring. The RobecoSAM CSA also was raised by investors as high quality, but the same investors lauding its quality claim it is less useful for investment research than other ratings because access to the underlying data and analysis is so limited. Trucost ESG Analysis, part of S&P Global, and several newer ratings and research providers like Truvalue Labs and S-Ray, which utilize artificial intelligence (AI) to gather ESG data and insights, were also mentioned as deserving attention.

Investor expectations of future ratings: Investors want ESG raters to provide real time data in shorter reports, and they hope that ESG will become better integrated into traditional financial reporting and research. They also expect companies to evolve their thinking around ESG to focus on what is most material and to provide better data that will allow investors to evaluate the impacts of products more easily. While some investors seek greater comparability between ratings, others value ratings diversity and do not want a single rating platform. All expressed a desire for better data.

Investor guidance for companies: Investors want companies to provide better ESG data disclosure, to focus on what is most material to the business and to more fully integrate ESG information into financial statements. Regular reporting, and, where possible, real-time information are keenly desired. Investors also strongly prefer to get ESG data all in one place, ideally via short ESG data or fact sheets instead of long reports. In addition to data, investors want better commentary on how leadership thinks about ESG and how it fits company strategy. They want to engage not just corporate sustainability teams, but also other business leaders including the CEO and CFO – investors expect senior company leaders to explain business strategy-ESG alignment. Finally, climate is a universal concern, with investors seeking information on climate exposure in accordance with the TCFD guidelines. The investors we spoke with clearly see the need for companies to take climate action, with one investor encapsulating that sense of urgency well: "Incremental isn't going to cut it – everyone needs to be more ambitious."

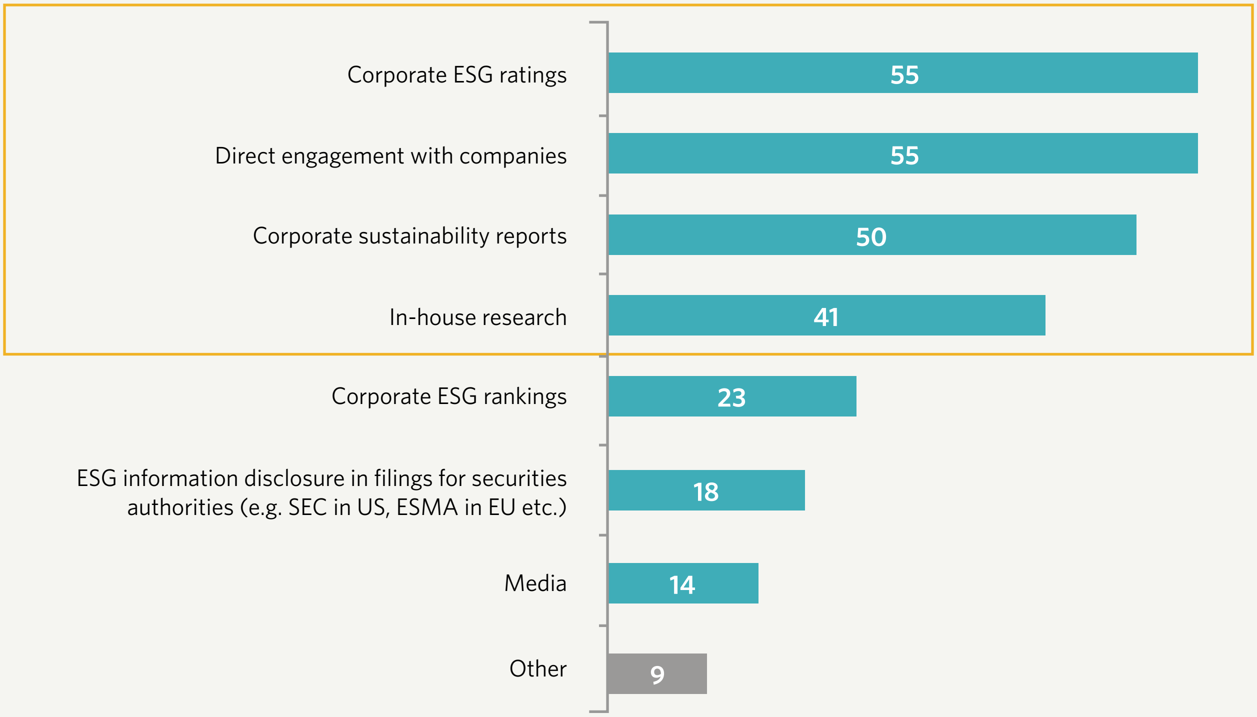
Investor Insights

Top Sources of ESG Information

ESG ratings, direct engagement, company reports and in-house research are the top sources of ESG information for investors

Investors were asked from where they source ESG information to inform their investment processes. The top four most useful sources of corporate ESG information cited from the survey were: corporate ESG ratings, direct engagement with companies, corporate sustainability reports and in-house research. These same four sources were mentioned most often across the interviews as well, with a slight preference for direct engagement with companies.

Most Useful Sources of Information on Corporate ESG Performance



?

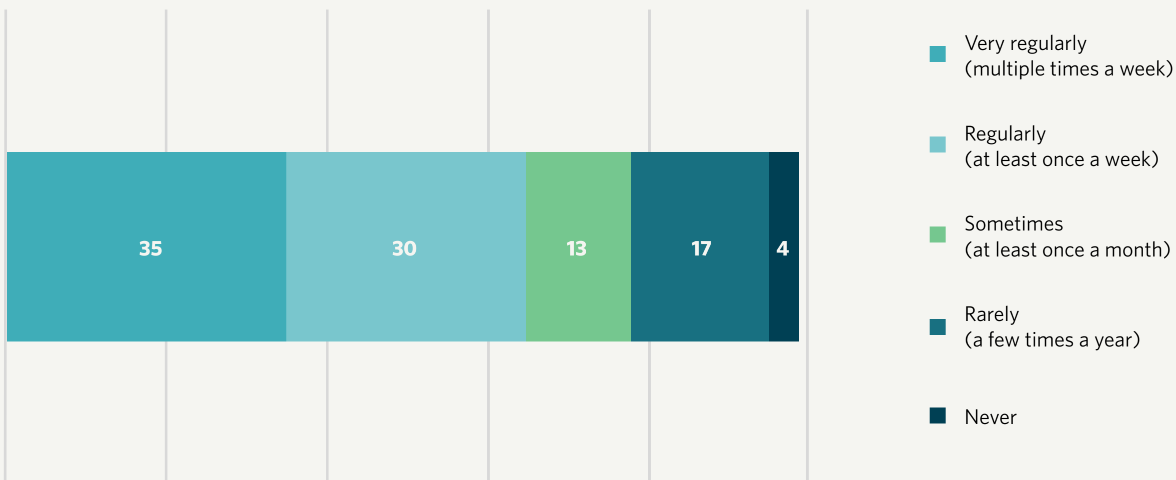
Question

What sources of information on corporate ESG performance do you find most useful when making investment decisions? Please select all that apply (n = 22). Bars indicate percentage of respondents who indicated each option. Respondents could select up to three.

ESG Ratings Use Frequency

65% of investors surveyed use ESG ratings at least once a week

ESG Ratings Use Frequency



Question

If you use ESG ratings in your work, how often do you use ESG ratings? (n = 25) Bars indicate % of respondents who indicated each option.

Most investors said they use ESG ratings "very regularly (multiple times a week)," often to track the status of portfolio companies or as part of a regular review process. However, a handful of active managers specifically mentioned they do not use ESG ratings at all.

> *"We review them very regularly (multiple times a week) and mostly in relation to engagement."*

> *"We use a systematic approach... we look at them [ESG ratings] ahead of every investment and then on an ongoing basis every quarter. We also have alert systems — we receive weekly emails of upgrades and downgrades. If there is something a PM (portfolio manager) is worried about, we would analyze the report that day, which could happen several times a day or once a week."*

> *"We strive to have quarterly risk review, but the reality is that the PM is constantly staying on top of their portfolio and the companies in their "watch list" of potential companies to invest in. So, it could be that they look at ESG ratings every other day, it just depends on how active the PM is."*

> *"Hardly. I find them of very limited value."*

Number of ESG Ratings Used

Investors often use more than one rating

Subscribing to and using more than one ESG rating has tangible benefits for investors. If one rating has a smaller coverage than another, or if one rating provides more data on a given sector or geographic region, subscribing to multiple can help fill the gaps. Almost all investors mentioned using more than one ESG rating to inform their research. Many larger asset management firms described using several, but noted that doing so can have significant cost implications.

How many ratings do you use?

> *"We use a wide variety of data sources — we don't want to rely on just one."*

> *"Ideally we would want to have many sources of ESG ratings and inputs. The ratings uncover slightly different things or have a slightly different perspectives; because we're very research driven, the more research you have the better."*

> *"We used to have access to both Sustainalytics and MSCI. Many large asset management companies use both databases. We don't want to rely on a single source; if you can have access to both that's great, but they charge a lot so it's difficult to pay for both data sources."*

ESG Ratings Selection

> *"When we judge quality of a rating and robustness of methodology, we want to know whether it is focused on materiality, if data is independently collected, whether they have methodology committees and oversight by experts. We also look into what kind of data quality assurance process they have to ensure the analysis they produce is accurate and timely."*

Investors regularly evaluate the best ratings

Every investor interviewed described an ongoing search for the best possible data set and tools to inform their research. Several have instilled regular ESG rating review cycles, sometimes annually, during which they assess all rating options and choose the best solutions.

How often are ratings evaluated?

> *"We evaluate our ratings every three years."*

> *"We review them each year."*

> *"We're currently rebuilding our team and re-evaluating which ratings to use... We will have the opportunity to look at other providers beyond MSCI, leveraging the intellectual property that's been developed in house."*

Factors that make a good rating: coverage, methodology, materiality, data quality and experienced research teams

Broad coverage of sectors and geography was mentioned most often across the interviews as a key factor in determining the quality of an ESG rating. Across the interviews and the survey, methodology quality and transparency, focus on material issues, data quality and experience of the research team were also mentioned most often.

Broad Coverage Across Sectors and Geographies: Although this was not an option listed in the survey it was consistently mentioned in the interviews.

> *"There are not many ESG ratings that are useful for large asset managers — we need large universal coverage."*

> *"Coverage is more important than quality. The company that provides the largest coverage is typically chosen because then we can embed its data in our own investment process."*

Quality of Methodology

> *"The biggest problem with most of these is that you can't tell where things came from. With a carbon emissions number, you know how it's calculated, what it is doing. A number or ABC score is interesting, but you don't know where it came from. It all comes down to methodology."*

Focus on Relevant/Material Issues

> *"In terms of mainstream ESG ratings (e.g. Sustainalytics, ISS, MSCI, etc.), we prefer the ones with more transparency and a materiality lens — not that they've figured it out for us."*

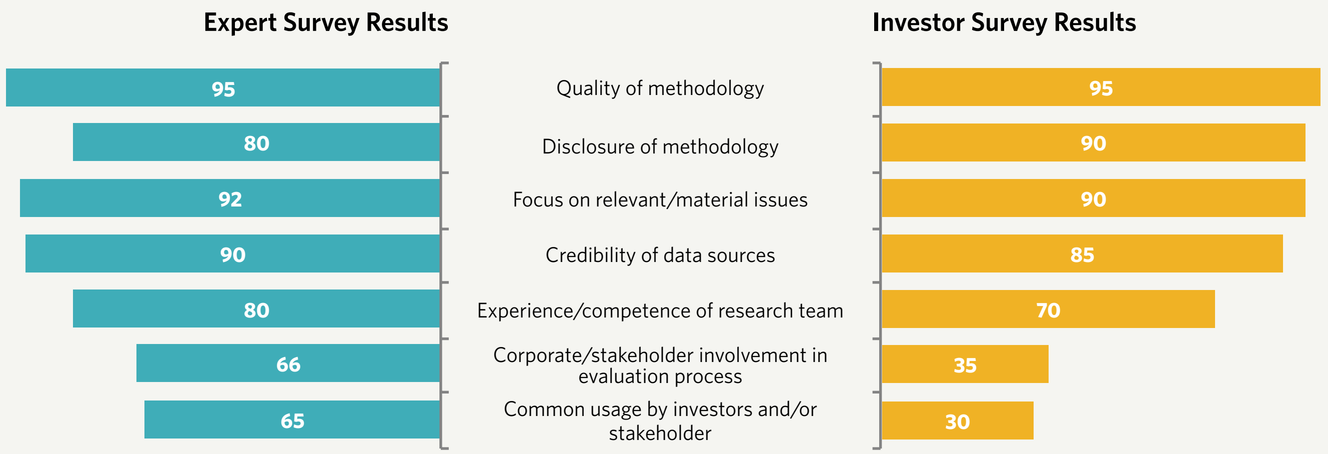
Credibility of Data Sources

> *"We look at how up to date a ratings report is [when evaluating the data]. We've seen some where the rating report wasn't updated for 3 years and the company put out a new report that was missed."*

Experience of Research Team

> *"We also look at quality of the research team (Master's-level experience or new grads) — tenure and seniority."*

Factors Determining ESG Rating Quality



Question

Please rate the importance of each of the following factors when determining the quality (i.e., excellence, robustness, and accuracy of evaluation) of an ESG rating. Please use a 5-point scale where 1 is not important at all and 5 is very important. (n=319)

Bars indicate % of respondents who selected a score of 4 or 5.

Question

Please rate the importance of each of the following factors when determining the quality (i.e., excellence, robustness, and accuracy of evaluation) of an ESG rating. Please use a 5-point scale where 1 is not important at all and 5 is very important. (n=20)

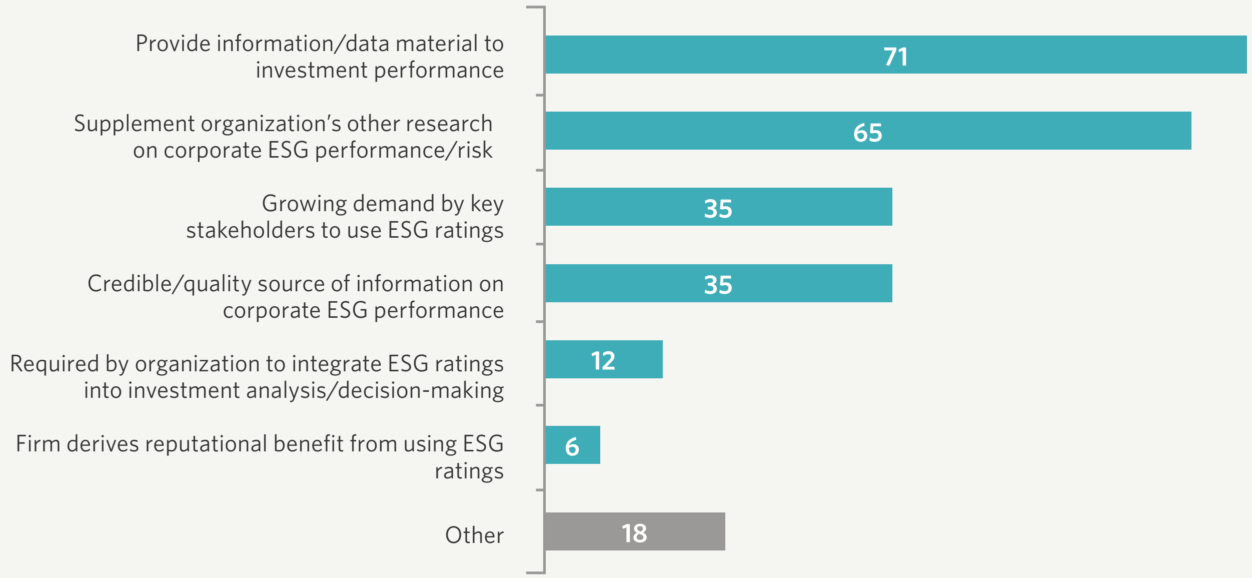
Bars indicate % of respondents who selected a score of 4 or 5.

How Investors Use ESG Ratings

Several themes emerged from the interviews about how investors approach corporate ESG analysis and how they use ESG ratings to inform their analysis. Many investment firms and asset managers have developed their own KPIs and fundamental ESG research; for them, ESG ratings are simply one data point in a larger body of research work. ESG ratings alone do not drive investment decision-making. Most mentioned relying on the data underlying ESG ratings scores more than the scores themselves, and that they use ratings as a starting point to help them understand the broader landscape; as a signal for further research or company engagement; and, in some cases, to exclude or identify best-in-class equities for specific ESG products.

"If you go around the world and ask people about sustainability ratings, I think you'll find with investors that we look at them, but don't take them as gospel. We don't take them at face value otherwise we'd outsource directly to them. That said, they are important and there is an anchoring effect if you see a low rating with a company and you start digging around and find a long list of troubles."

Reasons for Using ESG Ratings



Question

If you DO use ESG ratings very regularly, regularly, or sometimes, why? (n=17) Bars indicate percentage of respondents who indicated each option. Respondents could select up to three.

To inform their own ratings

Almost all investors interviewed described sophisticated approaches to ESG analysis, where ratings inform rather than drive investment decision-making. Especially for active managers, having a strong sense of which ESG factors are most important in a sector and developing their own evaluation of a company is critical. They want to rely on their own thinking, not someone else's. To support this, several have developed their own KPIs, tools, processes and scores to fully evaluate corporate ESG performance and "find our own answers." It is primarily this in-house investment research that forms the foundation for any buy, sell or hold decision, not any one externally sourced ESG rating.

> *"Ratings assume you can outsource the answers. We don't think you can. We think of this [ESG analysis] as a series of questions and it is incumbent on us to determine the issues and how to translate those issues into investment completion, e.g. what things will change due to climate change? We might look at climate pricing and then how to build that into how a company is managing climate. We have built our own tools to analyze and determine those outcomes."*

> *"As an active analyst you have to derive your own conclusions; you have to derive a thesis. We have [our] analysts derive their own score for companies ranging from best to worst depending on a company's sustainability profile and how it's evolving and to what extent its actions impact our underlying assumptions. Instead of taking ESG scores and putting them into a process, we actually adjust and get our own score out of it. And it's better."*

> *"We have an [internally developed] ESG risk score, and now also have internal sectoral KPIs. The basic idea is to create an ESG investment signal so portfolio managers have that tool in their portfolios. We have changed the forward-looking component to be aligned with SDGs and have created KPIs linked to each of the most financially relevant SDGs in each sector. We incorporate the Sustainalytics rating into that overall score."*

> *"Ratings inform our research and investment review of the company — we'll read the report and take our own view on the issues raised in the report."*

As a starting point, benchmarking tool and warning system

ESG ratings often serve as a starting point for an investment analyst. They can be used to help benchmark a company against peers, identify leaders and laggards or to get a general sense for the ESG landscape within a given sector. They may also serve as a warning system to signal further analysis or a search for additional information. Ultimately, for most, they are just one input in a larger analysis process.

> *"How you use ESG ratings is a good question; for us it's a starting point. Whereas for some people it's the end point, which suggests their approach is not very sophisticated or fundamental."*

> *"We generally take the rating and use it as one input... we want to make sure we're not missing anything... but we also run the scores by our research analysts and consult them about the issues."*

> *"MSCI helps identify the average performance in a sector and the leaders and laggards. That for us as an active manager is the most useful thing about these ratings. They help us organize the information in a structured and useful way. It's the peer benchmarking."*

> *"We start with ESG ratings. We review the ratings and produce reports for [investment] teams on a monthly basis. We then have our own flagging methodology on top of ratings that point to where we want to have a closer look. We're focusing on down-side risk. If there's something that looks alarming, we will get more information and then bring in portfolio management team to analyze further (e.g. through disclosure filings and our own research)."*

Using the data, not the scores

Most investors described using ESG ratings more for the underlying data and not the scores. Those that have their own internal scoring methodologies and KPIs do not need the scores. What they do need is a way to efficiently gather ESG data to feed these internal scoring and analysis mechanisms. This data feed is ultimately where ESG ratings are useful and why coverage is an important attribute when selecting which ratings an investor will buy.

> *"The [ratings] are all similar really, to be honest we don't really use them. We use the data in them, not the ratings. The data we use very systematically, it is an integral part of our proprietary process. For that you need raw data — so for MSCI we might use their carbon data, but not the ratings."*

> *"We do our own research, not to say we couldn't consume the ratings, we don't because we think they are fraught with issues. We're power users of ESG data, just not the score... We spend most of our time so far on company disclosed data - like everyone else we're on lookout for other data sets - things like scraping Glassdoor ratings for human capital data."*

> *"Most of the managers we prefer to use are buying multiple data providers and they throw out the scores, which we prefer because we don't think the scores are accurate; most of the good ones use 4–6 data providers' data sets, create their own scoring and then do their own analysis."*

> *"We still go through all the information in the ratings and weight them — we don't use their score per se, it's highly important to us to build our own opinion and also reach out to companies as well."*

Screenings/exclusions and direct engagement

Although investors said they mainly rely on the underlying data, they also noted instances when ratings may play a more direct role in the investment process. Some investors may use ESG ratings as an initial screen for specific investment products or portfolios. An ESG rating might be used to positively screen for "best-in-class" companies, or to negatively screen out the worst performing companies. Ratings may also prompt the investment team to push for more research and/or to engage directly with the company to find out more.

> *"Even though we don't use the rating to determine our investment decisions, there are many investors out there that DO use them for exclusions and so the company has to be aware of that."*

> *"There are also a few other funds, maybe a handful, that will have an official policy of not investing in any triple CCC rated MSCI companies — and that's a decision from the PM (portfolio manager). We also have some ESG funds that fully exclude any company that is on an ISS red list."*

> *"ESG research reports generated by these 3rd party providers help determine our targets for engagement. A rating might surprise us — a PM is excited about the stock, but the ESG rating isn't good — and it might help us identify who to talk to… we might need more information… or we might also encourage the company to disclose further."*

Evolving Investor ESG Team Structures

An important element shaping how investors use ratings is the evolving structure of investor ESG research teams themselves. Two decades ago the idea of an "ESG research team" or "integrated ESG" at an asset manager or bank was either limited or nonexistent. Today, many large asset managers have advanced teams of analysts and researchers to support ESG assessment and decision-making. We found that understanding how these teams are structured helps to inform how investors use ratings. The investors we spoke with described having ESG research teams that followed one of the following three structures:

1. **Independent ESG Research Team:** Individuals who focus on ESG research and analysis are grouped in teams separate from the main investment functions of the firm and serve to inform and guide those functions. One investor described a team of seven people who primarily conduct ESG research and company analysis, develop informed opinions on performance and provide that analysis to the portfolio managers who ultimately make the investment decisions. In this case, the in-house ESG team's research is also integrated into the Bloomberg terminals of the portfolio management team members so they can access ESG data from the terminal and the internal ESG team's research in one place.

2. **Partial Integration and Internal ESG Expert Team:** ESG research and analysis is built into the training and day-to-day work of portfolio managers and investment teams, and is supplemented by several internal ESG experts. In these cases, analysts across the firm may have integrated ESG assessments, templates and scorecards into their daily work. One interviewee identified about 40 people across their firm dedicated to ESG/impact investing full time in specific capacities. These teams were supported by "centralized experts" who would meet with clients to advise them, brainstorm new solutions or products and drive the overall ESG knowledge of the portfolio and product teams across the firm. The product teams then made investment decisions based on their own work and/or consultation with these centralized experts. This was the most commonly used approach across the firms we interviewed.

3. **Full ESG Integration:** In the most advanced cases, ESG is fully integrated across all functions in the firm. Each analyst, portfolio manager and product manager has an understanding of ESG and how to apply that analysis to their job function. There may be a centralized "council" or "advisory group" that can provide targeted support when needed, but the ESG "thinking" is baked into everyone's job responsibilities and all investment staff are trained on how to utilize and leverage this thinking for their clients. This integrated structure was described by only a few interviewees.

Key Takeaways for Companies

Identify priority investor ESG approaches:

Find out how your company's critical investors are using ESG ratings and research. Identify which issues they believe are critical for your company and sector and what data they need. Where possible, connect directly with investors or look to investor websites to identify their ESG approach.

Know your benchmark and be aware of red lists:

Know how you fare against your peers, are you ahead or behind? Monitor if/when your company appears at the bottom of its peer set and check for presence on any red lists. Both could result in exclusion from ESG investment products. If the company's position on an issue changes drastically or performance is poor, proactively communicate to investors how the issue is being managed and how the company plans to address the issue.

Know how ESG ratings compare or differ:

Pay close attention to when the company receives significantly different ratings from different ratings providers. Companies with disparate ESG ratings may need to be prepared for additional scrutiny.

Report on the management approach:

In addition to data, investors want to know how your company is approaching ESG from a management perspective. Work with internal stakeholders to align on a management approach and communicate about it to investors through reporting and investor relations engagements.

Investor Critiques of ESG ratings

ESG research firms and ratings have a role to play in the ESG ecosystem, and can help drive better ESG reporting and analysis, but there are limitations. While many investors use ESG ratings to supplement their own research, they had a variety of critiques. From simple things like typos to larger issues of data errors/inaccuracies, investors shared an overall sentiment that the analysis is not as advanced as it needs to be to inform investment decision-making.

> *"My personal experience… is that there is good/bad in all of these ratings. I almost want to say none is the best, but some in certain areas are better... Really hard to say who is best."*

> *"They are the best mediocre house in a bad neighborhood… not great quality. ESG ratings oversell massively what they can do, not transparent about the problems… machine-generated reports (errors and typos)."*

Inaccuracies, old data and backwards looking

At a fundamental level, ESG ratings don't always get the information right. Some of the errors investors complained about regarding accuracy indicate that there may be holes in the analysis process. ESG ratings are mostly backwards looking, evaluating past performance, when what investors and asset managers are really looking for are indicators for future performance. Investors also repeated a common corporate sentiment that ratings agencies often fall short in responding to company complaints of incorrect information.

> *"…always find accuracy problems, robo-smithing, copy/paste from other companies. Vendors are trying to improve quality, but not up to expectations for sell-side research especially."*

> *"We've been amazed at how different the data sets are on something like GHGs and the messiness and lack of consistency across those data sets. Carbon emissions data sets are different especially if a company isn't directly reporting... You can have Sustainalytics, MSCI, and CDP with different carbon emissions numbers for the same company."*

> *"They are a rearview mirror — they only tell you the past."*

> *"In the end, they should capture how well prepared companies are for the future, but they typically don't as they mainly measure reporting quality and size."*

> *"We also hear by the way that they [ESG ratings] aren't good at taking feedback. When companies find something wrong they just say "oh sorry"... We hear that they aren't staffed for strong support."*

Holes in underlying corporate data

Ratings rely on accurate, consistent and thorough underlying data from companies. While this does not make up for instances where publicly reported company information is incorrectly noted in an ESG research report/rating, it does point to a larger issue that overall, companies need to work towards greater ESG transparency, reporting and consistency especially within sectors. The Sustainability Accounting Standards Board (SASB), Task Force on Climate-related Financial Disclosures (TCFD) and others are working to promote better investment-ready reporting, but improved corporate disclosure is required as well.

> *"The core challenge is that the information isn't consistently reported — you can't download the D&I data for MSCI World from Bloomberg — so you can't use a consistent metric the way financial analysts are used to... The raters try to solve this issue by mashing it together into a number for every company, but if you look under the hood, some of them are just blanks."*

> *"We're at a point where primary disclosures of companies are not consistent; focus on that consistency and accuracy is evolving (frameworks like SASB will be really important rate of adoption) — without it there's a lot of subjectivity. The more robust and consistent reporting can get, the better served investors will be; pushing ESG data providers to up their game and adapt."*

Inexperienced research teams

Many investors noted that the seniority and tenure of research analysts that develop ESG ratings is not sufficient. Investors described a business model where research teams are spread too thin and thus do not have a deep enough understanding of the issues and sectors. Investors want to know they are getting the best analysis from an experienced professional with deep expertise across an industry. That said, these same investors still buy these ESG ratings products, signaling that while they may want stronger research teams, they are still willing to purchase the underlying data and analysis.

> *"We would appreciate 15–20 years of experience by analysts but often that is not the case with ESG ratings."*

> *"I think it's been a challenge for most of the ratings because they're spread so thin, and some analysts don't have a ton of experience. It's a fundamental business model challenge between experience and enough people to get the work done"*

> *"Quality of ESG ratings is an issue. Best research and ratings are provided by investment banks (sell-side) given that analysts who cover the sector have a very good understanding of companies and sectors. It is often not the case with ESG ratings analysts, who cover hundreds of companies and don't know them well. They often do a check-box exercise, use AI, which leads to lower quality. But they still pick up some issues that our mainstream analyst can't pick up."*

Investor analysts know better

Investors spoke of how their own research teams often have strong experience across sectors and companies. This experience is highly valued and results in a deeper trust of their own in-house analysis over that of a ratings agency. Several mentioned instances where the investment analyst disagreed with a ratings analyst and noted a sense that their own analysts deliver stronger work. This theme of "we do it better" permeated through the interviews creating a sense that while ESG ratings can help inform, investors believe the real thinking and analysis happens within their own firms.

> *"We have found that ESG data providers have huge teams doing great work, but our own analysts know the names and companies better. We use ESG ratings as a catalyst for further research."*

> *"The main reason we don't use ESG ratings is because we are better placed to make judgements on ESG performance than they are. Our analysts have 25 years of experience while ESG ratings providers will usually have younger graduates and have them work on a checklist of issues, which may not be critical to the way business operates and generates value."*

> *"Often our analyst may disagree with a rating because our analyst knows the company better. We have had instances where we put our analyst and the ESG research firm analyst on the phone together. We often find that 9 times out of 10 our analyst will just have more information than the rating provider and will direct them to a report or data point they may have missed."*

ESG cannot be distilled to one score

Given the sophisticated approach taken by the investors interviewed, several found it difficult to grasp how fundamental ESG analysis can be distilled down to one score. While not all ESG research firms take this approach, and those that do typically provide scores or ratings with detailed analysis for the score, investors ultimately want analysis that goes even deeper. It is that next level of analysis that investors often do themselves.

> *"We help our clients avoid some of the pitfalls [of ESG ratings], such as coming to a false comfort that an entire sustainability dataset can be boiled down to a set of numbers or a rating. In a nutshell, and not that we're demonizing them in any way, we think people should be aware of the caveats with ratings. A lot of this commentary, since we don't subscribe to ratings, is based on feedback we get from institutional investors — they're going through the great disillusionment — and getting more dissatisfied the more they look under the hood."*

> *"I understand a lot of vagueness that's used — sustainability covers a lot of bases, 'doing well by doing good' — it's about finding responsibly-run companies that are more likely contributing to a transition, and low-carbon, and diversity and etc. The more 'ands' you put into the analysis, which are not the same thing, the more you can't try to put it all together into one number."*

> *"The mere concept of combining all of this different, disparate information into one score — does it make sense? You do have to understand the next layer deeper to understand the issues."*

> *"I think people violently reject the idea that there is one number to boil it all down to and we then all can go home, but I think a lot of places are doing it that."*

Hiding behind ratings

Several investors also mentioned concern around how ratings are being used by their peers. Almost all investors we spoke with believe in the need for fundamental ESG research/analysis to inform investment decision-making. They worry that in the rush to meet the demand for ESG investment products, ratings may be a quick fix for firms that either don't have the resources for fundamental research or just want to check a box.

> *"Ratings are things people hide behind because they don't want to do the work. If you only have 2–3 people in investment research, they have to use ratings. They can't do all that research so they have to keep up the charade that ratings are useful. But, I think there's a growing understanding that ratings aren't useful that way. More and more people are realizing they have to build their own understanding."*

> *"Our fear is that there is a race to get [ESG investment] product out there... and ratings provide a way to do that quickly and check a box."*

> *"Ratings are an answer for which you have to mold the question — if you take ratings from MSCI or others and assume there is a 'good or bad ESG for a company' then all you have to do is get that answer. The reality is that's inaccurate. Different organizations have different views on an issue and there are different views on which companies are more exposed to those issues, so there is a whole plethora of answers."*

Key Takeaways for Companies

Continuously improve transparency and reporting:
Disclose KPIs and data to the best of your company's ability. The better the data and performance, the more likely it is for an investment team to reward your company for doing well through inclusion in ESG portfolios and investment products.

Promote data consistency across your industry:
Reach out to and work with peer companies within your industry to determine which ESG KPIs and data points are most relevant to investors. Utilize industry networks where possible and work together to promote consistent reporting and drive greater comparability.

Regularly review ESG ratings:
At a minimum annually review the company's ESG ratings/reports to check for any inaccuracies or old data and determine if you agree with the analysis and rating. We recommend regularly reviewing at least the larger ratings: MSCI, Sustainalytics, ISS, CDP and ideally those that you have identified as the main ratings your key investors are using.

Address mistakes:
If you identify incorrect data or an inaccurate rating, reach out to the rating firm to note any mistakes. If possible, ask to speak to the research team and get to know the analyst in charge of your company/sector. Even if the data/rating is not changed, it is important to have record of this outreach.

Investor Perceptions of Specific ESG Ratings

Across the interviews and survey, the ratings most favored by investors were MSCI and Sustainalytics, primarily because of their broad coverage. CDP and ISS were also frequently mentioned for quality and usefulness. The RobecoSAM CSA also was raised by investors in response to the query about which ratings they consider high quality, but investors specifically noted in interviews that the RobecoSAM CSA is less useful for investment research because investors have limited access to the underlying data and analysis. Trucost ESG Analysis, part of S&P Global, and several newer ratings and research providers like Truvalue Labs and S-Ray which utilize artificial intelligence (AI) to gather ESG data and insights were also mentioned.

Interview Results

Bloomberg ESG Disclosure Score: Few investors mentioned using the Bloomberg ESG Disclosure Score, though almost all mentioned use of the Bloomberg Terminal for data. One investor mentioned that they "look for consistency between ISS QualityScore, RobecoSAM, and Bloomberg ESG Disclosure Ratings," while another noted using a low Bloomberg ESG Disclosure Score as flagging potential governance issues.

CDP: Most investors noted using CDP for the data it provides, stating, for example, that "We've found most useful the underlying performance data, we use emissions data directly, we don't use the scoring" and "It has a lot of good qualitative information." However, several also noted data gaps, as reflected in comments like "data tends to be spotty because not a whole lot of companies report on CDP, so quality is okay, but usefulness is limited" and "The carbon, water, etc. information is sometimes useful at a sector-level, but sometimes comparability can be an issue." Overall, investors noted that CDP "produces good work and high quality sector reports," but again that they most often utilize CDP data as opposed to CDP analysis.

FTSE Russell's ESG Ratings: FTSE Russell's ratings were mentioned less often, but a few investors noted that they prefer FTSE Russell to other ratings. One interviewee compared it favorably to Sustainalytics. Another noted that the "Russell 1000 product fits easily into public equities allocation while still providing a mix of companies." Two investors also commented that the green revenues data is "interesting" and complimented the group's "great efforts there," but also stated that they are still evaluating it, with one interviewee mentioning "concerns around over-claiming and the methodology being overly simplistic."

ISS

The suite of ISS Ratings: Investors commented on two ISS ratings, giving specific praise to the ISS QualityScore (specifically the Governance score) and ISS-Ethix. Multiple investors noted ISS has the "best governance reports," the best research on proxy reporting, and the best negative screening on ethical criteria. A few criticized that ISS was "too strict sometimes - if you breach international conventions, you are automatically in the red, and sometimes we feel like there should be a larger span of 'seriousness.'" Similar to other ratings, several also noted "good data, but low usefulness for the score." One investor also called out ISS-Oekom because "It has a part of the methodology that looks at products in more depth than others, which I think is really important; it is absurd to say any company is an ESG leader if you're not looking at its products."

MSCI

MSCI: MSCI was one of the most often mentioned ratings by investors, and much like Sustainalytics, investors explained that they subscribe to MSCI for its broad coverage. One noted that "Because we don't take ESG ratings out of the gate, we also combine them with fundamental research, we really like MSCI because of the qualitative reports that accompany scores - that transparency gives a better understanding of how they got the score. If we disagree, we can make adjustments." In a similar vein, another noted that "we like the data set, but don't like the scoring." Investors were impressed with MSCI due to their perception that it has the "methodology most oriented towards the investment use case." MSCI was also described as one of the best known ratings "you see the most products launched across their data," but it was also stated that it has "historically has been very black box-ey." One investor also pointed to MSCI's integration into the Barra risk system as their reason for using MSCI, as it makes it easier to plug it into current evaluation methods.

ROBECOSAM

RobecoSAM Corporate Sustainability Assessment (CSA; the rating underlying the Dow Jones Sustainability Indices (DJSI)): Overall, the investors interviewed said that they do not use RobecoSAM's CSA for investment decision making, stating "we don't really use it" and "we never look at that." Investors explained that they do not care if companies are included in the index because "The methodology isn't transparent; no one knows what's behind it" or because they perceive that "It's a beauty contest." While there was a sense of respect for the RobecoSAM CSA given that "It's a nice signal of strong sustainability," it was never mentioned in the interviews as a tool for investment decisions. Instead, investors said "It occupies a position in corporate sphere where it has high profile, but it's tiny in impacting any investing decision-making." Investors also described a lack of coverage of DJSI because it is self-selecting (one has to fill out a survey) and because the data isn't available. One investor in particular lamented about how much proprietary data likely lives within the RobecoSAM assessment, but is inaccessible: "There must be treasure troves of data in there, but who knows how much a company's legal team would agree to have publicly disclosed."

SUSTAINALYTICS

Sustainalytics: Similar to MSCI, Sustainalytics was one of the most often mentioned ratings by investors. Investors emphasized its broad coverage, although one investor expressed the need for better coverage in the Nordic region. One said that Sustainalytics is "stronger on core sustainable performance in the classical sense," while another noted Sustainalytics has done a good job to "try and apply more materiality (and aligning more with SASB), which is a move in the right direction." Several commented that they look at Sustainalytics as "similar to MSCI" but one noted they felt Sustainalytics was "more transparent, but has a lot of instances where they are missing pieces of the analysis." As Sustainalytics continues to evolve to address investor and company needs, investors appreciate its specific products such as its carbon risk products.

THOMSON REUTERS

Thomson Reuter's ESG Scores (Replacement of ASSET4): Investors prefer Thomson Reuters for its raw data, noting that "It's not great for analysts without context, but good for specialists." One investor commented that "we think of it as more similar to a Bloomberg in terms of access to company reported data vs. a rating," while another said that the quality of "the quant data is okay, but the qualitative data is not useful." One investor also noted using it in quantitative strategies, where the underlying computation is based on Thomson Reuter's scores.

Investor Survey Results and Comparison to 2019 Expert Survey

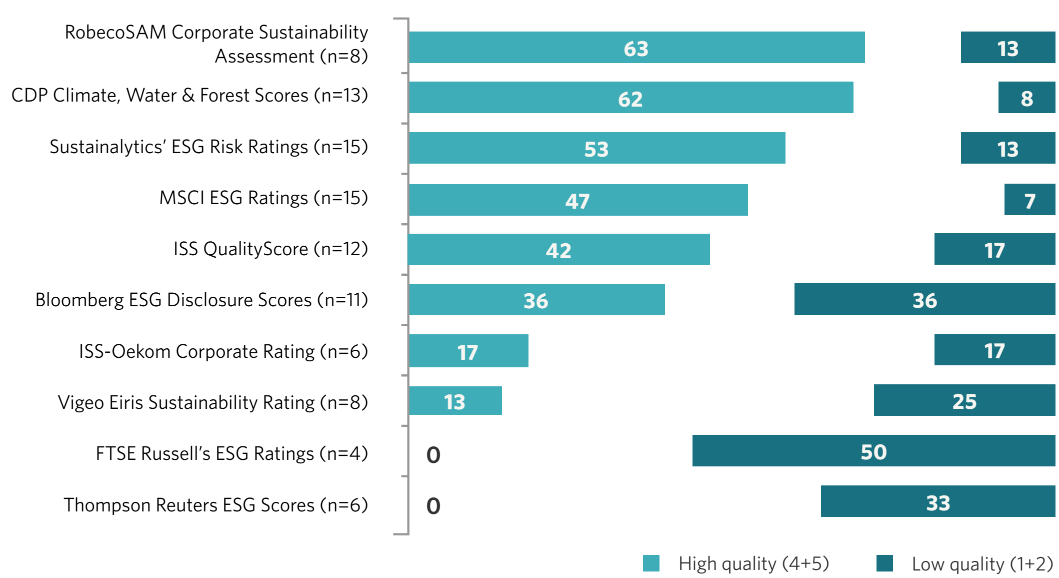
The following charts compare selected results from this 2020 investor survey and the 2019 Expert Views on ESG Ratings. The difference in methodology between these two reports is important to note. While this 2020 investor report was informed primarily by interviews and complemented by a survey, our 2019 report on expert views was primarily survey driven. The number of respondents was significantly different as well, with 25 respondents for the investor survey versus 319 respondents for the expert survey.

Rating Quality

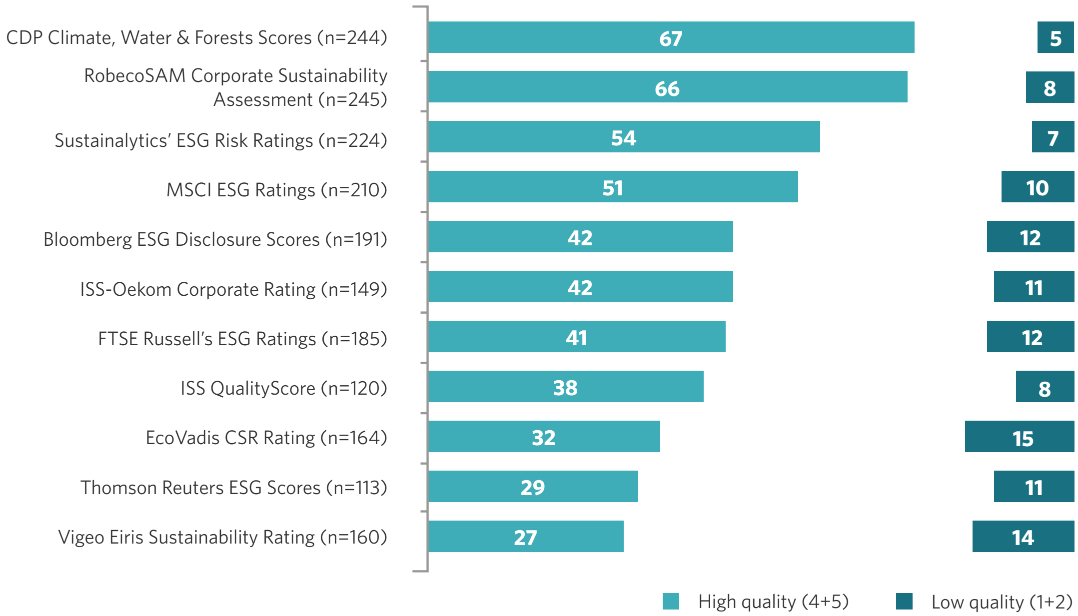
Looking at the survey results for the question asking respondents to evaluate the quality of a series of ratings listed in the survey, RobecoSAM, CDP, Sustainalytics and MSCI were highest rated by both investors and experts, while the ISS Quality Score was notably far more positively evaluated by investors vs. experts.

The differences in n-value, or sample size, for the responses to questions in the investor survey are important also. We interpret that a higher n-value (the number of respondents who rated the quality of a given rating) indicates that more investors were familiar with the rating. Therefore, it is notable that Sustainalytics, MSCI, CDP, ISS Quality Score and Bloomberg had the highest n-values for the investor survey. When comparing these five ratings to responses related to RobecoSAM, while 63% of investor respondents gave RobecoSAM a 4/5 for quality, the small n-value of eight means that only five people actually rated it as such. By comparison, while Sustainalytics received a 4/5 for quality from 53% of participating investors, the n-value of 15 means that eight respondents evaluated it as high quality.

Investor Survey: ESG Ratings Quality



Expert Survey: ESG Ratings Quality



Question

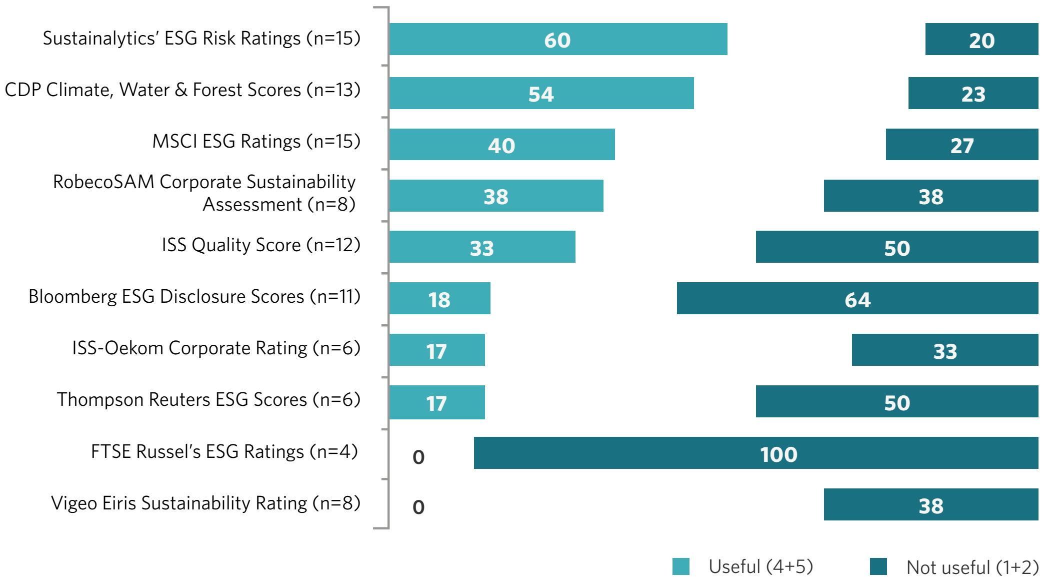
Please rate the following ESG ratings based on: a) Quality (i.e., excellence, robustness, and accuracy of evaluation). Please use a 5-point scale, where 1 is very low quality and 5 is very high quality. Bars indicate percent of respondents who viewed the rating as either high quality (4+5) or low quality (1+2).

Rating Usefulness

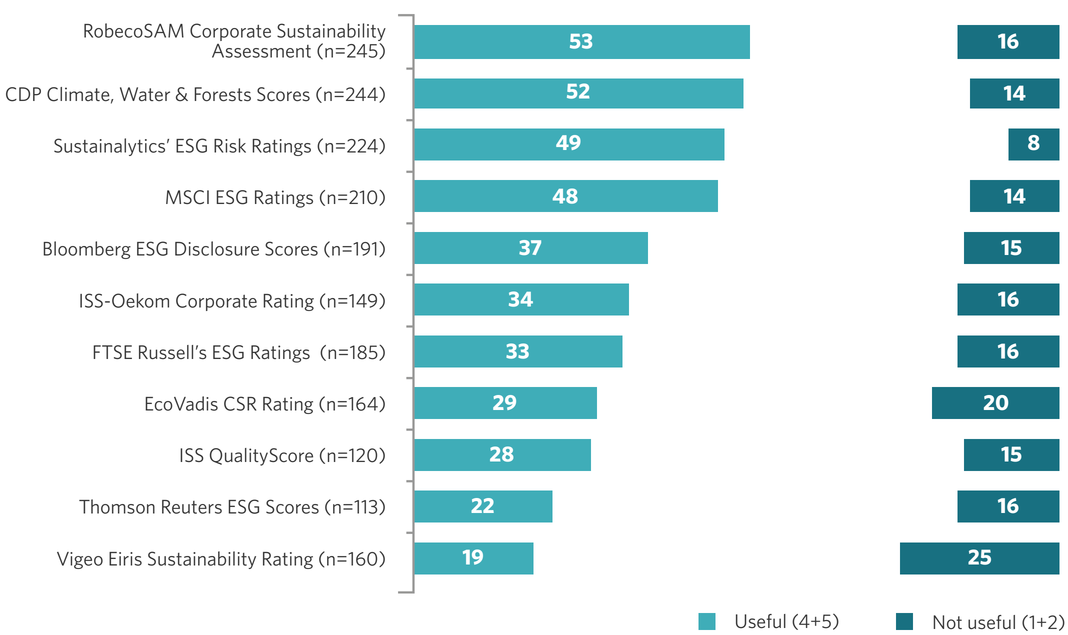
The survey question asking investor and expert respondents to evaluate the usefulness of a series of ratings had similar results to the question on quality outlined above. The same four firms were highly rated on usefulness, with Sustainalytics, RobecoSAM, CDP and MSCI topping the list for both investors and experts. The ISS Quality Score was again rated higher by investors than experts, whereas investors rated the Bloomberg ESG Disclosure much lower than experts.

The differing n-values are important again, with Sustainalytics, MSCI, CDP, ISS Quality Score and Bloomberg having the highest n-values. When comparing these five ratings to RobecoSAM, while RobecoSAM had 38% of investor respondents who gave it a 4/5 for usefulness, the small n-value of eight means that only three people actually rated it as such. By comparison, Sustainalytics, which had 60% of investor respondents give it a 4/5 for usefulness, had an n-value of 15, meaning that nine people considered it to be highly useful.

Investor Survey: ESG Ratings Usefulness



Expert Survey: ESG Ratings Usefulness



Question

Please rate the following ESG ratings based on: b) Usefulness (i.e., how useful they are). Please use a 5-point scale where 1 is not useful at all and 5 is very useful. Bars indicate percent of respondents who viewed the rating as either high usefulness (4+5) or not useful (1+2).

Other Mentions and Interest in Big Data/ Artificial Intelligence

When asked to mention which ratings they thought were highest quality in open-ended questions on the survey and in the interviews, investors cited MSCI, Sustainalytics and CDP most often. Investors also mentioned ratings/research providers that were not listed in the forced rating question on our survey, including Impact Cubed IC, GRESB, Truvalue Labs and 2 degrees investing. In several interviews also, organizations like Truvalue Labs and tools like Arabesque S-Ray were mentioned and praised for how they use big data, artificial intelligence (AI) and machine learning to provide unbiased information, and for how they source data from places such as Glassdoor in order to provide a more granular picture of company performance. One investor in the interviews noted how strongly they felt "Trucost is missing from the list… they differentiate for climate data particularly and as environmental economists, they have a lot of expertise." while several others noted Trucost for it's climate risk analysis.

Key Takeaways for Companies

Prioritize ESG ratings:

Understand how and why ratings are useful to your company and then prioritize those most useful to driving strategic outcomes for your organization. If your company wants to use ratings to inform investors about its ESG performance, MSCI, Sustainalytics, the ISS Quality Score and CDP are likely to be important and of high utility. Regardless of which ratings are prioritized, direct disclosure/reporting and engagement with investors will still be critical.

Carefully consider the RobecoSAM CSA:

Participation in the CSA takes significant time. We recommend companies closely evaluate whether it is worth the effort. If a company is new to ESG, the process of responding to the CSA may help educate internal stakeholders, build internal processes for gathering ESG data and instigate discussions on management of ESG issues – all positive. However, such benefits may not be as useful to a company with more advanced ESG management and performance. Companies more familiar with ESG disclosure may be better off dedicating resources to driving better ESG performance in the company and to direct investor engagement. While the CSA set a record for responses in 2019 with over 1,100 companies participating, the value derived from participation varies considerably and the time required should not be invested automatically.

Watch for new ratings using big data/AI:

Stay abreast of the latest ratings and monitor how new tools like AI are being utilized by investors. Specifically, ask your key investors how they apply such tools in their investment approach; their answers will help inform your company's ESG data disclosure strategy.

Get help:

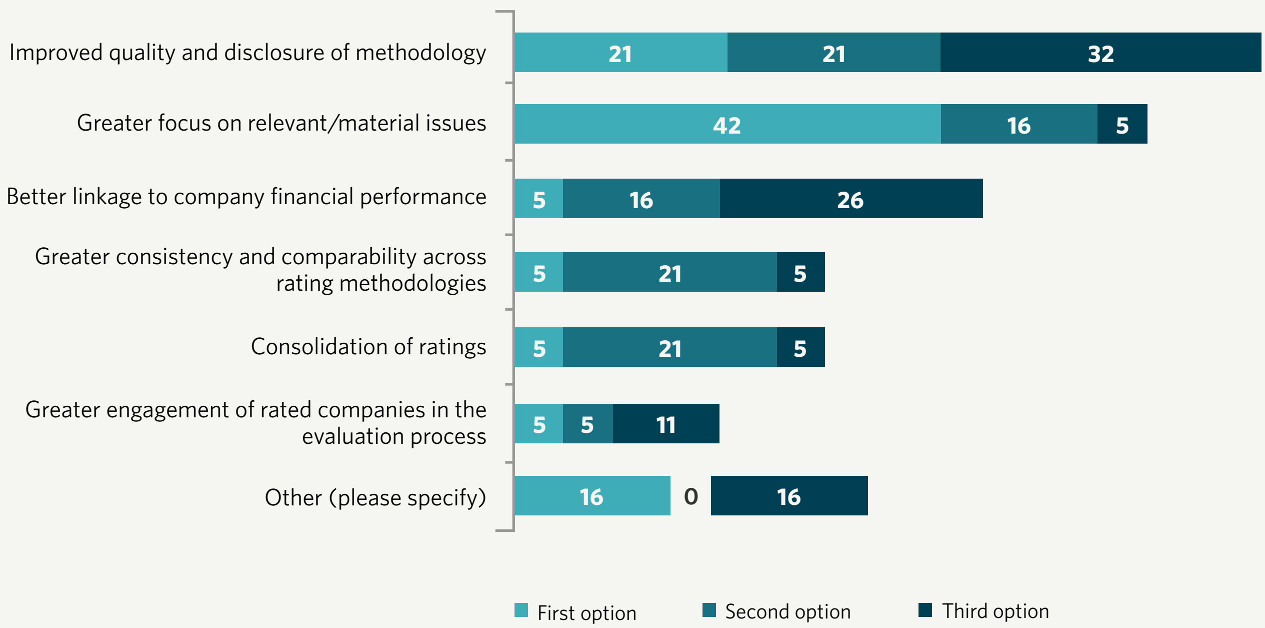
SustainAbility/ERM has supported dozens of companies in prioritizing which ESG ratings are most critical to the business and in developing response strategies for specific ratings. See the contact information at the end of this report if you are interested in learning more about how we can support your team.

Investor Future Views and Expectations

Investor Future Views and Expectations

In general, investors recognize that ESG ratings and rankings are not going away any time soon. When asked what changes and solutions they would like to see in the next five years the leading responses from the survey were to: improve the quality and disclosure of rating methodologies, a greater focus on material issues and a stronger link to company financial performance. These expectations were reiterated in the interviews along with a desire for more timely coverage, more data, integration of ESG into financial reporting and the ability to evaluate corporate societal impact vs. just operational performance.

Preferred changes and solutions in next five years



Question

Which of the following changes and solutions would you like to see in the next five years for ESG ratings to better serve companies, investors, and other stakeholders? Please pick the top three and rank from 1 to 3, where 1 is the change/solution you would most like to see. (n=19) Bars indicate percentage of respondents who indicated each option. Respondents could select up to three

Real time data and shorter reports

Investors want to collect and compile timely ESG data in a way that minimizes analyst time spent gathering information. They noted that it would be helpful if ESG ratings (especially controversy ratings) were more frequently updated to help with real-time decision-making. Additionally, respondents want the data to be more easily accessible with higher quality summaries and shorter, more digestible reports along with greater transparency around rating methodologies.

> *"An investor's value is their own interpretation of data. It would be helpful to not have to spend time getting that data... we believe that if you interpret the data, you have a competitive edge. So, it's better to use analyst's capacity for interpretation rather than collecting data themselves."*

> *"We would love to see more frequent ratings (cycle and updates)"*

> *"We want less focus on massive reports, more focus on ease of access info, timeliness of updates, greater transparency of data sources and high quality qualitative summaries that are more up to date."*

> *"We want more specificity - more transparency/simplicity about how they calculated things so people can choose the right analysis for the right situation -- not lumping things all into one number."*

ESG integration with financial reporting

Investors are looking for companies to embed ESG information into financial reporting and believe that doing so will help improve ratings quality. They also want to see ESG information integrated into credit ratings and sell side analysis to support investment research. By better linking sustainability to financial impact both companies and ESG research providers will enable stronger investment research.

> *"Embedding ESG in financial information will improve the quality issue we're having with current independent ESG ratings providers. It would help if any information that any investor will look at around ESG has a KPI and companies report on it regularly."*

> *"It would be helpful if mainstream credit providers include ESG alongside their reports, not integrated/ hidden somewhere in there."*

> *"We want more sell-side, existing research firms to incorporate ESG information in their service, that's the change and solution we will see. It's also quite difficult though, because we want independent ESG analysis; we expect both existing financial raters and the sell-side will start incorporating ESG."*

> *"The industry needs to do a stronger job of linking sustainability impacts to financials; longer term strategic risks that can shape competitive advantages."*

Focus on material issues and impact evaluation

Investors want both ratings providers and companies to focus more on material issues and communicate in a meaningful way how those issues tie to the business strategy. They are looking for rating providers to consider the actual ESG impact of the products (both positive and negative) that a company produces. What the company does is just as important as how it operates. There is also a desire for ratings to better explain how dynamic ESG issues like climate change will affect a company's product mix and business performance.

> *"Really comes back to… a focus by companies on a small set of material metrics, ideally aligned with something like SASB and tying that to their business strategy and communicating that."*

> *"Companies need to evolve their thinking around ESG to make it more material and meaningful to investors. Particularly around product; it's shameful we've allowed ESG to be defined by just how a company operates not what it does. It's nonsense that we've allowed companies to be seen as sustainability leaders when they're producing products that destroy the planet."*

> *"I would say that there is obvious scope for these ratings to talk more about the impact of the company, because at the moment they evaluate primarily the management of these issues. Sustainable business is about how a company operates and what it does - these ratings are good at the how not at the what… we'd be interested in a rating that properly assessed the net contribution of a company to society."*

> *"Ratings need to be able to rate the products and markets companies are selling into, to have an ability to look at market share and product growth because of how they are aligned with ESG megatrends. For instance, thinking about a company selling de-icing salts and how climate change will affect its business."*

Disagreement on ratings consistency vs. differentiation

One area in which investors were split, was whether it is better to drive greater comparability and ratings standardization or to keep ratings differentiated. Some argue for harmonization across ratings, expecting them to become more comparable. Others argue that each rating provides a unique perspective on an organization, and as long as they have the ability to look across multiple ratings, there is value in having different types of insights.

> *"We would like harmonization. We have seen that the ratings are not aligned, ten ESG ratings would rank companies very differently."*

> *"Methodology and comparability has to come first. Because if it's not comparable, it's useless. We need standardization."*

> *"They shouldn't do a ratings standard. We don't want a single rating in 20 years, we want data."*

> *"It's inconvenient for investors to have so many different opinions because it's hard to consolidate and have one version of truth, but at same time diversity of thought is fantastic; if we have data providers looking at company through different lens then makes us all smarter and more equipped to make better conclusions. It would make our jobs easier, but may reduce the insights that we can glean from all these different intelligent people trying to do some good."*

Final Recommendations for Companies

Final Recommendations for Companies

At different points in this report we list key takeaways for companies. Here we present the best of those mixed with our own perspectives on how companies can get the most out of ESG ratings and improve ESG data disclosure.

1. **Own your data and your story:** Do not rely on ESG ratings to tell your story or to fill your ESG data gaps with estimates. Take ownership by reporting robust data regularly and in a consistent manner. Tell the story of what your numbers mean by framing the data in terms of trends over time, comparison to peers and impact on company financial performance.

2. **Make your data "investor ready":** Investors value the context companies provide in reports, but prefer data that is investment ready, by which they mean: easily accessible, accessible in one place and structured in a manner that allows the data to be fed quickly into their own systems (e.g. investors like charts, tables and numbers). A table of numerical results or an ESG "data sheet"usually is perceived as more useful to investors than a body of text.

3. **Identify priority investor ESG approaches and proactively engage:** Find out how your key investors are using ESG ratings and research. Identify which issues they believe are critical for your company and sector and what data they desire. Proactively engage with investors on your company's ESG strategy and management approach, especially if/when performance is poor.

4. **Prioritize among ESG ratings:** Understand how and why ratings can drive strategic outcomes for your organization and prioritize time towards those that best enable those outcomes. If the company wants to use ratings to inform investors about its ESG performance, MSCI, Sustainalytics, the ISS Quality Score and CDP are likely to be important and of high utility.

5. **Monitor and manage priority ESG ratings:** Regularly review company reports from relevant ratings and stay up to date on methodologies. Be proactive in identifying and reporting inaccuracies and addressing mistakes directly with rating organizations.

6. **Know your benchmark and be aware of red lists:** Track if/when your company appears at the bottom of its peer set in ratings and check for your organization's presence on any red lists, as either can result in exclusion from ESG investment products.

7. **Ensure ESG drives performance, not just reporting:** Reporting, transparency and ratings are only as good as the underlying corporate ESG strategy and performance. Dedicate resources to driving action on material issues and improved performance, which will ultimately drive better ratings.

SustainAbility/ERM has supported dozens of companies with all of the above. If you are interested in learning how we could support your team, **see the contact information at the end of this report.**

Conclusion

Conclusion

As investors mature in their approach to evaluating ESG performance, as companies are more proactive and transparent on ESG disclosure, and as new tools emerge, the nature and role of ESG ratings will continue to evolve. In this shifting environment, strong and open dialogue between companies, investors and ESG research firms is needed to help improve the flow of ESG data from companies to investors as well as the manner in which the data is used.

Throughout the decade since the original Rate the Raters research series began, SustainAbility has remained dedicated to exploring how the ESG ratings ecosystem can evolve in ways that better support and inform all stakeholders. We plan to extend this work by launching an ESG-focused member network. This new network will enable improved engagement between companies, investors and ESG research firms while improving ESG-related practices. One of the goals of the network will be to explore possible means to make the collection and utilization of ESG data more efficient and accurate. The network will offer webinars, convene in-person meetings and produce white papers and other reports. Please reach out to one of the contacts listed below if this network interests you.

We look forward to continuing conversation on ESG and exploring further questions and potential solutions. We welcome any feedback, ideas or questions.

Contacts

For more information, questions, comments or to learn how SustainAbility, an ERM group company, can support your team, please contact:

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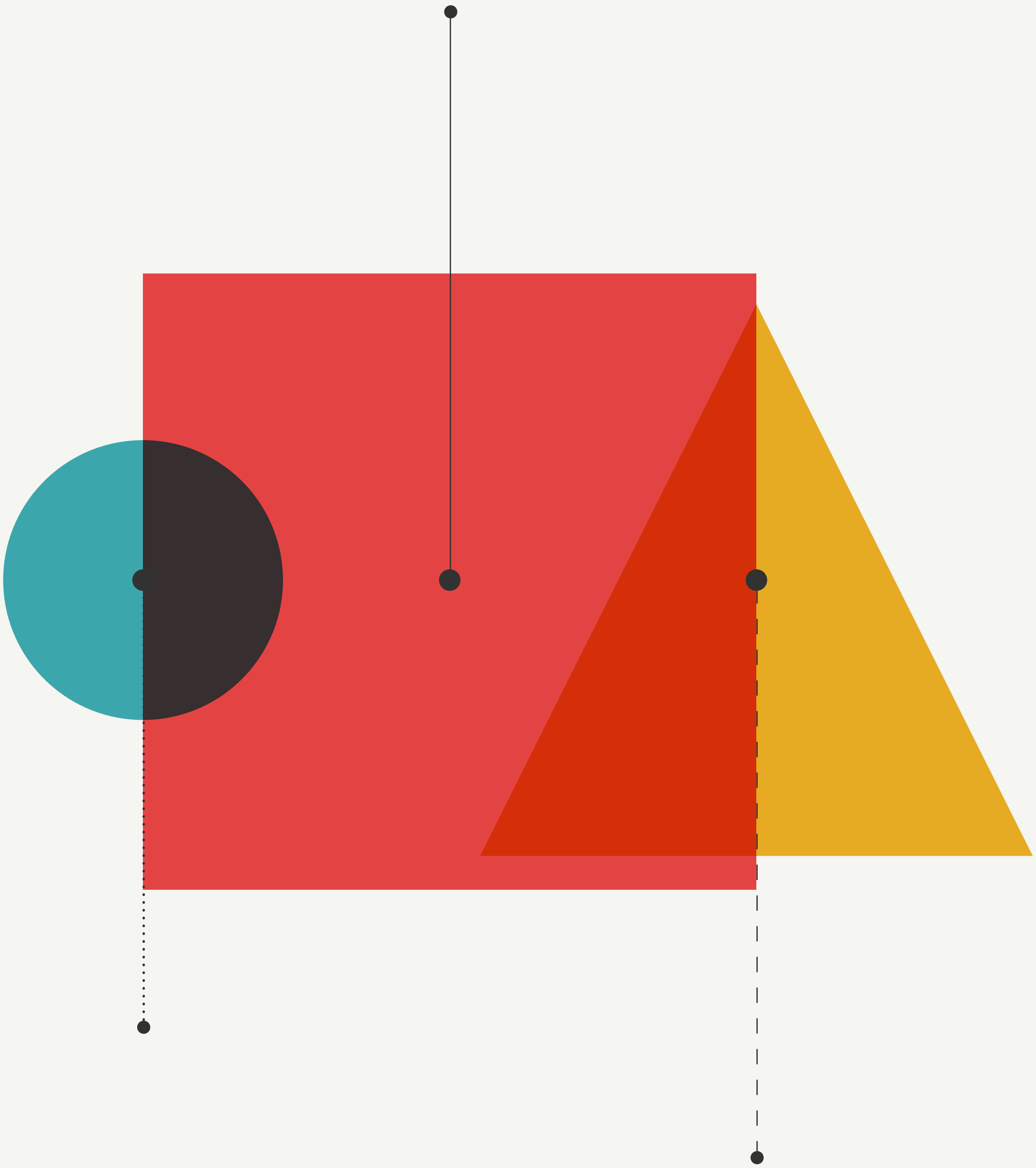
Appendix



Survey questions

Which sources of information on corporate ESG performance do you find most useful when making investment decisions? Please select your top three.

a. Direct engagement with companies
b. Corporate sustainability reports
c. ESG information disclosure in filings for securities authorities (e.g. SEC in US, ESMA in EU, etc.)
d. Corporate ESG ratings (i.e. score-based evaluations of companies that provide an assessment of performance on environmental, social and governance issues)
e. Corporate ESG rankings (i.e. lists that classify companies based on their performance and put them in a certain order or grouping based on a specified grading system)
f. In-house research
g. Media
h. Government or regulatory agency databases
i. I do not incorporate ESG data when making investment decisions
j. Other (please specify)

How often do you use ESG ratings in your work?

a. Very regularly (multiple times a week)
b. Regularly (at least once a week)
c. Sometimes (at least once a month)
d. Rarely (a few times a year)
e. Never

If you DO use ESG ratings very regularly, regularly or sometimes, why and how? Please pick top three reasons.

a. I am required by my organization to integrate corporate ESG ratings into investment analysis and decision-making
b. There is a growing demand by key stakeholders to use the ESG information provided by ESG ratings
c. ESG ratings provide information/data that is material to investment performance
d. ESG ratings are a credible/quality source of information on corporate ESG performance
e. ESG ratings supplement my organization's other research on corporate ESG performance/risk
f. My firm derives reputational benefit from using ESG ratings
g. Other (please specify)

If you rarely or never use ESG ratings, why? Please pick top three reasons.

- a Lack of interest in ESG-related information on companies
- b ESG data analysis falls outside of my role/remit
- c ESG ratings do not provide the relevant information/data that I need on corporate ESG performance
- d ESG ratings to do not focus on material issues
- e ESG ratings' methodologies are not high quality enough
- f ESG ratings' methodologies are not transparent
- g I use other sources (e.g. company sustainability reports, interviews, etc.) to gather information on company ESG performance
- h Other (please specify)

Please rate the importance of each of the following factors when determining the quality (i.e. excellence, robustness and accuracy of evaluation) of an ESG rating. Please use a 5-point scale where 1 is not important at all and 5 is very important.

- a Credibility of data sources
- b Disclosure of methodology
- c Quality of methodology
- d Experience/competence of research team
- e Focus on relevant/material issues
- f Corporate and stakeholder involvement in the evaluation process
- g Common usage by investors and/or other stakeholders
- h Other (Please specify and rate)

Which ESG ratings do you consider to be of highest quality (i.e. excellence, robustness and accuracy of evaluation)? Please consider both broad, combined ESG ratings and those specific to individual industries or ESG issues. Please enter a maximum of three ESG ratings in the spaces provided.

- a Rating #1: _____________________
- b Rating #2: _____________________
- c Rating #3: _____________________

Please rate the following ESG ratings based on:

- a **Quality** (i.e. excellence, robustness and accuracy of evaluation) – Please use a 5-point scale, where 1 is very low quality and 5 is very high quality.
- b **Usefulness** (i.e. how useful they are) – Please a 5-point scale where 1 is not useful at all and 5 is very useful.

Only rate the ratings that you are familiar with. If you are unfamiliar with the rating, please select "Not familiar with rating."

- a Bloomberg ESG Disclosure Scores
- b CDP Climate, Water and Forests Scores
- c EcoVadis CSR Rating
- d FTSE Russell's ESG Ratings
- e ISS QualityScore
- f MSCI ESG Ratings
- g ISS-Oekom Corporate Rating
- h RobecoSAM Corporate Sustainability Assessment (CSA; the rating underlying the Dow Jones Sustainability Indices (DJSI))
- i Sustainalytics' ESG Risk Ratings
- j Thomson Reuters ESG Scores (replacement of ASSET4)
- k Vigeo Eiris Sustainability Rating

How do you use ESG ratings? Please select the top three responses.

- a As a basis for engagement with companies on their ESG performance/ To push companies to improve ESG performance
- b As a basis for further in house research on corporate ESG performance
- c To determine companies or sectors to exclude from a fund/ portfolio (negative screening)
- d To determine companies or sectors to include in a fund/ portfolio (positive screening)
- e To determine corporate ESG performance relative to peers (best-in-class)
- f To select companies that will improve the ESG performance of an existing portfolio (tilt)
- g We do not use ESG ratings
- h Other (please specify)

Which of the following changes and solutions would you like to see in the next five years for ESG ratings to better serve companies, investors and other stakeholders? Please pick the top three and rank from 1 to 3, where 1 is the change/solution you would most like to see.

- a. Improved quality and disclosure of methodology
- b. Consolidation of ratings
- c. Greater consistency and comparability across rating methodologies
- d. Greater focus on relevant/material issues
- e. Greater engagement of rated companies in the evaluation process
- f. Better linkage to financial performance
- g. Other (please specify)