



**Response: IOSCO Consultation Report on ESG Ratings and
Data Product Providers
2 September 2021**

Background

The World Federation of Exchanges (WFE) is the global trade association for regulated exchanges and clearing houses. We represent over 250 market-infrastructures, spread across the Asia-Pacific region (~37%), EMEA (~43%) and the Americas (~20%). with everything from local entities in emerging markets to groups based in major financial centres. Collectively, member exchanges are home to nearly 53,000 listed companies, and the market capitalisation of these entities is over \$95 trillion, while the 50 distinct CCP clearing services (both vertically integrated and stand-alone) collectively ensure that traders put up \$1 trillion of resources to back their risk positions.

With extensive experience of developing and enforcing high standards of conduct, WFE members support an orderly, secure, fair and transparent environment for investors; for companies that raise capital; and for all who deal with financial risk. We seek outcomes that maximise financial stability, consumer confidence and economic growth. And we engage with policy makers and regulators in an open, collaborative way, reflecting the central, public role that exchanges and CCPs play in an internationally integrated financial system.

If you have any further questions, or wish to follow-up on our contribution, the WFE remains at your disposal. Please contact:

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IOSCO (International Organization of Securities Commissions) Consultation Report on ESG Ratings and Data Products Providers

The WFE welcomes the opportunity to comment on this consultation. The demand for ESG-integrated and sustainability-themed investment continues to grow, and asset managers are increasingly turning to ESG data and ratings providers to analyze the sustainability track record of companies in which they are invested. As service providers diversify their offerings to the market, users of these products and services have raised concerns on a number of issues including but not limited to: (i) over-reliance on ESG data and ratings, (ii) governance of these firms, and (iii) transparency of underlying methodologies. The WFE believe that the work of the IOSCO Sustainable Taskforce on this issue is timely in determining whether intervention is required. Our members believe that IOSCO's Sustainable Taskforce is well placed to oversee a set of principles or a Code of Conduct which would embed good governance practices within these organisations. The WFE, in its capacity as Vice Chair of IOSCO's Associate Member Consultative Committee (AMCC) stands ready to assist IOSCO with its efforts, and in particular will be able to provide considerable industry expertise in shaping such principles.

As part of our [Annual Sustainability Survey](#), 87% of WFE members say they either require or encourage issuers to report against a standard, but the lack of high-quality, comparable, and consistent ESG disclosure remains one of biggest challenges. The absence of globally harmonized minimum standards for disclosure has undoubtedly compounded the reliance that ESG-focused investors place on ESG ratings and data products. This issue is not just limited to investors, as the underlying data that feeds into ESG models and scoring also needs to improve in order to reduce the need for estimations and improve comparability of ESG scoring. We therefore support the need for more informative disclosure from issuers at entity and, where relevant, sub entity level. It is right that policy and regulatory efforts are concentrated on this, and we welcome the ongoing work to harmonize sustainability reporting standards.

With regards to ESG ratings methodologies, our members recognize the divergences in approach taken by different providers but are not in favour of completely eliminating them. In fact, varying ESG methodologies, judgment and data provide investors with choice and help to enrich disclosure. Instead, we believe service providers should demonstrate transparency and accountability in the way they conduct their methodologies. This can help investors understand the additional due diligence that may be required when utilizing third-party ratings.

As financial-services entities that deal with issuers, the sell side and investors, market infrastructure providers are ideally placed to be able to promote good practice, dialogue, and enhanced data flows across the investment chain. Several members have long-standing partnerships with leading providers, or in-house data and ratings capabilities and are keen to provide investors with the tools to ensure effective capital-allocation decisions through: helping to manage their exposure to ESG risks and opportunities; meeting their mandated stewardship requirements; and implementing ESG-aware investment strategies.

Nonetheless, our members are equally aware of the potential concerns for investors posed by the way these service providers operate, with a number of regulators already wading into this debate. For example, the European Commission released a [study](#) on Sustainability-Related Ratings, Data and Research, and followed up with dedicating a section to this within its [public consultation](#) on the renewed sustainable finance strategy. Meanwhile, a number of European regulators have set out [proposals](#) for a European regulatory framework for providers of sustainability-related services. Even with standardization in reporting frameworks, we do not envisage the role of sustainability-related service providers dissipating. Given the evolving nature of this landscape, we would suggest that as a first step IOSCO explore voluntary levers such as principles or a code of conduct before proposing alternative, harder measures.

Specific Observations

Recommendations for Regulators/ IOSCO

- The proliferation in ESG ratings and data products continues in response to investor interest in channeling investment into companies that prioritise sustainability issues. We would suggest that a prudent first step would be the development of an industry-led set of guidelines/principles or a code of conduct. IOSCO could have a role to play in convening a group of expert industry participants as well as overseeing the development of any principles/code. We believe that the onus at this stage should be on using voluntary levers and that it may be more appropriate for individual jurisdictions to monitor uptake with any principles to take account of local developments. The principles/code might then be subject to a review period, and if at this point there is insufficient progress to address market concerns then IOSCO should suggest alternative measures.
- We would encourage IOSCO to consider the [‘Best Practice Principles for Shareholder Voting Research’](#) which are market-led principles that were established to provide transparency around the role of proxy voting agencies and any consequent voting decisions made by institutional investors. Some of key principles require signatories to publicly disclose their research methodology as well as policies and procedures for conflicts of interest -- issues which could also arise with ESG ratings providers. ESG data and ratings are a critical service for investors who can have considerable influence over the responsible allocation, management, and oversight of capital. We would further recommend that where possible, these market participants should seek to become signatories to the principles for service providers for example, under the existing UK Stewardship Code or equivalent codes.
- Any principles/code should also set out good practice in corporate governance, for example, through ensuring that there is sufficient independence, objectivity, and challenge at the board level through the recruitment of Non-Executive Directors and that pay is overseen by a Remuneration Committee. Existing practices can also give rise to other governance issues in the form of conflicts of interest, where service providers may be generating profit from providing additional services to the same issuer (eg, consulting). To ensure their integrity and credibility, we agree with IOSCO that providers should exercise a degree of operational separation to enable the delivery of high-quality services.
- Whilst we recognise the existence of a broad spectrum of ESG scores and data products, some of our members are concerned with the wide ranging definitions used by IOSCO. Instead, we would ask that IOSCO define the application of its recommendations in consideration of existing standards and regulations in order to prevent potential overlap. For instance, sustainability-related indices and credit ratings are already subject to high standards in certain jurisdictions, and should not be included in the understanding of ESG scoring and data products.
- To help with future proofing, we would recommend standardization in definitions and terminology (eg ‘best in class’ or ‘negative screening’) are addressed as part of any principles/code, and that service providers are asked to begin disclosing aspects of their methodologies. Market participants including end investors and issuers should legitimately expect to have adequate visibility and access to the underlying assessment that

leads to ESG scoring. As IOSCO note, this should include the ESG factors used, the weight of each factor, absolute or relative scoring, materiality, and industry ranking considerations. This will help users with consistency, comparability, and interpretation of ratings. We recognize that this is a crucial component of the ESG rating process and that not every aspect of a provider's methodology can be disclosed. In order to maintain competitive advantage between service providers, firms should disclose a general description of the weighting philosophy.

Recommendations for Issuers and the Interaction with Service Providers

- The subscription 'investor pays' model requires service providers to rely on public disclosure or survey information to inform their ratings. To the extent possible, our members believe that ratings should be based on transparent, reliable public data in order to minimize the use of estimations. Furthermore, the use of publicly disclosed information can reduce the cost of information acquisition and should also encourage issuers to improve the quality of their disclosures.
- IOSCO suggests that the investor-pays model can create significant data gaps, which service providers may try to fill using other measures. Furthermore, issuers have reported difficulty in engaging with service providers on a regular basis to provide data corrections in a timely manner. They argue that this inappropriately prevents them from receiving more accurate scores or ratings, and there is a risk to investors in the form of inaccurate and misleading data being used to inform investment decisions. The investor-pays model is, however, usually associated with a higher quality service, as the rater is completely independent from the assessed company. Companies have sufficient incentive to engage with ratings providers—even if they do not pay them directly and market discipline will drive up rater responsiveness to new issuer data.
- One way in which to resolve these issues might be for 'Terms of Engagement' between issuers and service providers to build in specific provisions for a data review period which aligns with a company's public disclosure process. Data gaps could be addressed through enabling the sharing of commercially sensitive information, which could lead to better informed ratings, but commercial contracts should carve out this information from public disclosure.