

September 3, 2021

Via electronic mail

Martin Moloney and Kris Nathanail-Brighton
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain



Re: IIF Public Comment on ESG Ratings and Data Products Providers

Dear Mr. Moloney and Ms. Nathanail-Brighton,

The Institute of International Finance (IIF) and its members, which broadly represent the global financial services industry, appreciate the opportunity to provide public comments to the International Organization of Securities Commissions (IOSCO) on its Consultation Report on *Environmental, Social, and Governance (ESG) Ratings and Data Product Providers*¹ (hereafter “the consultation”). The IIF is the global association of the financial industry, with more than 450 members from over 70 countries, including commercial and investment banks, asset managers, insurance companies, ratings agencies, market infrastructure providers, and professional services firms. The comments in this letter have been informed by discussions of the IIF Sustainable Finance Working Group (SFWG), chaired by Judson Berkey (Managing Director and Group Head of Sustainability Regulatory Strategy, UBS) and the IIF Special Committee on Effective Regulation (SCER), chaired by John Dugan (Chair, Citigroup).

1. Executive Summary

IOSCO’s early action on this topic is welcome; the consultation is an important and helpful step to establish a dynamic and robust market and to support global alignment of market and policy frameworks for ESG ratings and data products. As described below, financial firms are increasingly reliant on ESG ratings and data for a range of purposes, including as inputs to risk management activities, capital allocation decisions, product development, voluntary and mandatory reporting and disclosures.

From a User perspective, **financial firms recognize a number of the current challenges that IOSCO raises in the consultation,** including:

- i) **clarity on what a product is intended to measure** (e.g., ESG risk or sustainability impact);
- ii) **transparency** of underlying methodologies, data inputs, and processes; and
- iii) **difficulty in discerning product quality and suitability** given that lack of clarity and transparency.

To address these challenges, we recommend that IOSCO and its members consider the following next steps:

¹ <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD681.pdf>.

- i) **Develop a clear classification framework for ESG ratings and data products, and associated use cases**, recognizing that there are a variety of use cases for ESG ratings and data, each of which may merit different policy considerations and approaches;
- ii) **Facilitate the market-led development of industry standards and codes of conduct** for the market for ESG ratings and data products;
- iii) **Provide high-level guidance** on how regulators could practically take initial steps in this area, **including on minimum safeguards for quality and transparency**;
- iv) **Foster alignment in jurisdictional approaches** to ESG ratings and data products to reduce the risk of jurisdictional fragmentation; and
- v) **Engage proactively with relevant prudential authorities and policymakers to ensure that the use of ESG ratings and data is not directly or indirectly required** in regulatory or supervisory frameworks (e.g., for disclosure, risk management, product construction, or scenario analysis) **without a strong understanding of the intended uses and limitations of those products.**

2. Overarching Messages

The rapidly growing and developing market for ESG-related products and services, the desire of financial institutions to assess and manage their exposure to ESG-related risks and sustainability impacts, and an increasing number of regulatory requirements have heightened the importance of and demand for ESG ratings, data and analytics. The strong interest from the corporate and financial sectors, the public sector, and civil society to scale up capital in support of the transition to a more sustainable economy highlights the need for robust and trusted ESG ratings and data products as foundational inputs to research, analysis, business decisions and disclosures. Capital flows to ESG-aligned funds are increasing; as of July 2021, the global ESG-aligned fund universe was valued at over \$2.5 trillion, having increased from just over \$1.5 trillion in 2019². In addition, an increasing number of financial institutions have made strategic plans and commitments to reduce their financed emissions, and many have set targets to align portfolios and business models with Net-Zero goals.

The products and services being developed by ESG Ratings and Data Providers³ can have a significant influence on decision-making by financial institutions and other Users, and on mandatory regulatory requirements (e.g., for ESG disclosures); they can, therefore, influence how markets for sustainable finance may develop. Many financial institutions and corporates are looking to information and tools provided by third-party vendors, usually in addition to data they source directly from public sources and their clients. The same financial institutions and corporates are also in many cases covered by Providers. Policymakers, regulators and a number of voluntary frameworks are analyzing (and sometimes referencing) these ESG ratings and data products as they develop their own approaches on topics such as

² IIF 2021. "[IIF Green Weekly Insight: ESG Funds-More Please!](#)" (July)

³ This response uses the terms 'Providers', 'Users' and 'Covered Entities' throughout, reflecting the terms used in the consultation. Like IOSCO, this response also refers to 'ESG Ratings and Data Products' as short-hand for the wide variety of products and services discussed in the consultation report.

ESG-related disclosures, product construction, risk management expectations and net-zero commitments.

IOSCO's early action on this topic is welcome; the consultation is an important and helpful step to establish a robust, transparent, innovative and upstanding market, and to support global alignment of market and policy frameworks for ESG ratings and data products. Now is a prime moment to clarify emerging issues and open questions, and establish global consensus on appropriate approaches to building strong standards in this new and growing market. Given the rising importance and influence of ESG ratings and data products, it is important that IOSCO and its membership work with all stakeholders in the global marketplace (Providers, Users, Covered Entities) to support sound market development and appropriate use of ESG ratings, data products, and other services.

Further, as a global standard-setting body, IOSCO can also use its authority to **foster alignment in jurisdictional approaches to ESG ratings and data products to reduce the risk of jurisdictional fragmentation**, which could negatively affect competition and potentially constrain innovation in the global marketplace. We would encourage IOSCO to actively engage with its member regulators and with other global standard-setting bodies and voluntary leadership coalitions to ensure a common understanding of the role of ESG ratings and data products. Of particular importance is how such products and services are considered within (or are directly or indirectly endorsed by) supervisory, regulatory and voluntary frameworks, particularly where voluntary frameworks are referenced in official-sector policies, expectations, or requirements⁴.

In general, IIF members consider that **IOSCO's proposed Recommendations, on which we provide detailed feedback in section four of this response, can serve as a set of global principles for IOSCO members and the industry to refer to.** Such principles would provide a sound basis for further industry and regulatory efforts to evolve the market for ESG ratings and data products in a robust way, for example through the development of **industry standards and codes of conduct**. Given the importance of ESG ratings and data products as an input to understanding how companies – and ultimately, countries – are transitioning to meet expectations and commitments related to the Paris Agreement and the Sustainable Development Goals⁵, it is important that IOSCO continues to monitor and assess developments in this market and consider whether any significant regulatory interventions might be needed in future.

3. General perspectives on the role of ESG Ratings and Data Products, and the evolving ESG Ratings and Data marketplace

Financial institutions are increasingly reliant on ESG ratings and data for a range of purposes, including as inputs to risk management activities, capital allocation decisions,

⁴ One example is the case of disclosure requirements which reference the Task Force on Climate-related Financial Disclosures (TCFD) framework. The TCFD's recent [Consultation on Proposed Guidance for Climate-related Metrics, Targets, and Transition Plans](#) suggests that new forward-looking metrics – such as portfolio temperature alignment – which are currently offered by a limited number of Providers may be recommended by the TCFD.

⁵ For example, in the case of climate-related risks, through the use of sovereign and corporate physical risk assessments, and corporate transition risk assessments (temperature alignment, transition preparedness measures).

product development, voluntary and mandatory reporting and disclosures. ESG ratings and data products are important tools that financial institutions reference to meet their corporate ESG objectives and commitments, as well as an evolving set of stakeholder expectations, including from regulatory authorities, to assess and respond to ESG risks, opportunities, and impacts. As users of ESG ratings and data, financial institutions consider such products and services to be critical from a strategic, operational, and compliance perspective. Financial institutions are also often the *subject* of ESG ratings and data products (also referred to as ‘covered entities’), such as sustainability ratings and ESG benchmark analysis, and a firm’s ESG rating or score is becoming an important part of their profile for investment decision-making.

As discussed in the consultation, the market for ESG ratings and data products is extremely diverse. Different Providers offer a wide range of products, with varying degrees of detail and levels of granularity. In addition to broad ESG ratings, scorings or rankings and data products, some Providers deliver products and advisory services or solutions focused on individual environmental, social, or governance factors, such as climate risks (for instance, measures of physical risk exposure or transition risk impacts). Providers use different and often proprietary methods of categorizing ESG risks and opportunities, different approaches to gathering and transforming data, and exhibit important differences in their definitions of materiality. Moreover, they can distinguish themselves by specializing in particular regions, sectors and asset classes⁶. For this reason, financial institutions often obtain products and services from more than one Provider; despite this, in some cases there are still significant gaps and a challenging lack of granularity, particularly for smaller corporates and certain geographic regions. This diversity in the marketplace makes it challenging to develop a common set of standards or expectations for the range of different Providers. Nevertheless, certain minimum principles relating to governance, integrity, conflicts of interest, transparency, data collection, and commercial policies could add value and be widely applicable.

The market for ESG ratings and data products is developing quickly in terms of the market participants, products and services being offered and the methodologies used. As discussed in the consultation, there are currently a large number of Providers worldwide. Some are niche firms offering bespoke solutions relevant to specific policy and regulatory interests, e.g., scenario analysis and portfolio warming potential. Some products may focus on ESG risk to Covered Entities, while other products may focus on the sustainability impact of Covered Entities’ business activities. Separately, the market structure is evolving. Large mainstream data providers and credit ratings agencies have increased acquisitions and expansions, with greater vertical integration across ESG data, research and provision of other services. On the one hand, more integration can increase maturity in market practices and reduce sources of undue variation between ESG ratings or scorings for the same Covered Entities. On the other hand, this could increase the risk of some large firms gaining significant influence in what is becoming an indispensable market for financial institutions and other groups of Users. Sound principles in these areas would therefore add considerable value.

There is a high degree of innovation in the market, and a desire to meet increasing demand from different stakeholders. Providers are evolving their products and services and their underlying methodologies quickly in light of new data, tools and scientific information on

⁶ IIF 2020. “[IIF Green Weekly Insight Charting Course: Mapping ESG Data Providers](#)” (July 9).

ESG topics, including physical and transition climate-related risks. Market practices are also maturing over time, which is also indicated by the current steps to consolidate within the industry.

These dynamics are important to consider in the policy context, and make it challenging to treat the ESG ratings and data products market in the same way as other more established markets, for instance the market for credit ratings⁷. While a comparison is often drawn with the credit rating market in order to explore solutions to some of the current challenges in the ESG ratings market, it is important to recognize the key differences between credit ratings and ESG ratings, scorings or rankings. For instance, credit ratings have a much higher level of correlation as credit default has a very clear definition shared by all. In contrast, ESG ratings are much broader and measure a range of different factors. While a credit rating is an assessment of a borrower's willingness and ability to repay obligations, an ESG rating may measure both sustainability-related risks and opportunities. When investors make decisions based on ESG data or third-party assessments, they should maintain independent judgement to determine which pieces of information are of most importance to them. **These two markets do have certain elements in common, however, including the importance of integrity, independence of methodologies used, the need for appropriate transparency and regular, meaningful dialogue between Providers and Covered Entities.** Therefore, it may be possible to learn from aspects of the established credit rating process.

From a User perspective, financial firms experience a number of the current challenges that IOSCO raises in the consultation, including:

- i) **clarity of what a product is intended to measure** (e.g., ESG risk or sustainability impact);
- ii) **transparency** of underlying methodologies, data inputs, and processes; and
- iii) **difficulty in discerning product quality and suitability** given that lack of clarity and transparency.

Clarity on what different ratings and data products are intended to measure and capture is extremely important and not always clearly articulated. It would be beneficial for Providers of ESG ratings or scorings to make a clear statement about what exactly they are assessing, and over what time horizon.⁸ For example, it is not always clear whether a rating or score is intended to measure ESG risk to an organization or the sustainability impact of that organization. While ESG risk and sustainability impact can be related, they are different measures that should not be conflated. ESG risk, sometimes referred to as 'materiality', measures the risk that ESG factors pose to the performance of an organization. Sustainability impact, often referred to as 'double materiality', measures the impact of an organization on the environment and society. While sustainability impacts may present ESG risks, the two measures are not one and the same. Without such clarity, ESG ratings and data products that are sustainability impact oriented may be inappropriately used to measure ESG risk. This can be

⁷ Some financial institutions are wary of the term 'ESG ratings' in case it conflates ESG assessments with credit ratings, which differ in several ways including regulatory treatment.

⁸ Although different, Providers of credit ratings clearly state what the rating represents; for example, near-term or long-term probability of default, or timeliness of payment and willingness to pay a credit obligation.

particularly problematic in the context of integrating ESG ratings or data into credit ratings, where ESG risk should be approached through the same lens and with the same rigor as existing credit rating agency processes. It is, therefore, essential that Providers offer clarity and transparency on what different ratings and data products are intended to measure.

In addition, greater transparency about the inputs to ESG ratings and data products, and greater standardization in the data collection process, is crucial to allow Users to interpret them appropriately and discern product quality and suitability. It would be useful to distinguish, and therefore clarify, the criteria, methodologies and assumptions that are taken into consideration for issuing ESG ratings, scorings or rankings from those used for data processing and ESG analysis. In the case of ESG ratings, underlying methodologies are based on different choices, judgements, assumptions (including weightings) and data proxies, which are often not disclosed. For example, some Providers calculate a Covered Entity's rating based on an assessment relative to a Covered Entity's peers. This element of the rating is generally not transparent, and it is also questionable the degree to which this element genuinely reflects a Covered Entity's ESG risk management. If a lack of transparency results in a rating that cannot be readily replicated (even with a full data set), this can create a "black box" situation. This lack of transparency means that Users and Covered Entities may not be able to understand readily the drivers of differing ESG ratings or data points between entities or for the same entity, which can vary for a number of legitimate reasons. Moreover, without transparency, Providers do not have accountability for methodological or data errors, stale ratings or data, or other issues. While Providers have a legitimate interest in avoiding disclosing commercially sensitive information, this must be balanced with Users' and Covered Entities' need for greater transparency.

Without clarity and transparency, it is extremely challenging for Users to discern product quality and suitability. For example, the quality, comprehensiveness, and comparability of offerings of ESG ratings and data can vary significantly, presenting challenges for financial firms that use such ratings to inform lending and investment decisions, risk management and the development of financial products. For these reasons, many financial firms prefer to collect data from multiple sources - including different vendors, public databases and client data - and undertake their own ESG assessments, rather than relying fully on certain external ESG ratings or data products. Nevertheless, Users also recognize that some of the current limitations in the ESG ratings and data product market stem from broader, industry-wide challenges related to incomplete or poor quality ESG disclosures by corporates and public sector entities. Some financial market participants are also concerned about potential conflicts of interest that could arise if a given Provider offers both ESG ratings/scorings on a company, and also provides Second Party Opinions or other consultancy services to the same company. Among other things, these challenges make it difficult for Users to discern product quality and suitability, and have the potential to expose financial institutions to a risk of perceived or actual 'greenwashing'.

Additionally, there could be benefits in terms of efficiency and effectiveness for Users if Providers enhance the functionality of their products over time so that they are easier to incorporate into a User's data and risk systems. For example, allowing Users to easily download datasets, providing an application programming interface (API) to link a Provider's applications to a User's existing systems, and providing standardized data identification information where available (e.g., stock ticker, ISIN code, etc.) to allow better dataset matching

and merging. Such practical steps make it easier for financial institutions to apply ESG data products as part of their risk assessments and decision-making processes.

It is extremely important that securities regulators and prudential authorities have a strong understanding of the uses and limitations of ESG ratings and specific data products before implementing regulation or supervisory expectations that require the use of ESG ratings and data (either directly or indirectly) – e.g., in disclosure, product construction, risk management and scenario analysis expectations. Financial institutions now face a considerable, and growing, number of requirements or expectations to assess, manage and mitigate exposure to ESG-related risks and sustainability impacts. To satisfy these expectations, many financial institutions refer to third-party Providers as a supplementary source of information, in addition to public databases, corporate disclosures, client data and in-house analysis and judgement. As one example, financial institution disclosure requirements can function as an indirect requirement to use ESG ratings and data from third-party Providers. This can be problematic when regulatory requirements outstrip the maturity of data availability and quality.

Further, it is important for IOSCO to assess with its membership the impact of structural factors, which vary across jurisdictions, on the growing ESG ratings and data product space. This notably includes accounting for incomplete coverage – e.g., for smaller companies, certain counterparties (e.g., some sovereigns), or geographic regions – and avoiding any potential overreliance of financial institutions on specific external providers to meet prudential requirements. In the case of traditional credit ratings, there are legal restrictions in place in some jurisdictions (such as in the United States under the Dodd-Frank Wall Street Reform and Consumer Protection Act, introduced after experiences during the global financial crisis) that prohibit prudential authorities from referencing external credit ratings in regulatory requirements.

4. Specific Feedback on IOSCO’s Draft Recommendations

The IIF and its members are broadly supportive of IOSCO’s proposed Recommendations for securities markets regulators, ESG ratings and data product Providers, Users of these products and services, and companies subject to these providers’ review. Further views on the specific Recommendations included in the consultation are detailed below.

The IIF and its members believe that the proposed Recommendations can serve as a useful set of global principles that official sector and industry stakeholders can draw upon to ensure a high level of clarity, transparency, and robustness in the marketplace for ESG ratings and data products. A set of global principles, serving as a basis for common approaches, can help avoid the risk of future fragmentation as this global marketplace continues to evolve. Any jurisdictional policy frameworks for ESG service providers developed by IOSCO Members should leverage global principles, with the aim of supporting transparency, independence and objectivity, while enabling strong competition in the market. Global principles could also provide a good basis for industry-developed standards and codes of conduct (see below), which should be encouraged and supported at this time.

Global principles should recognize the nascent aspects of the marketplace and allow time for specific products and services (e.g., those underlying portfolio alignment

approaches) to mature, while also reflecting their emerging indispensable nature to market practices and therefore establishing minimum safeguards for quality and transparency. In addition, it is important to recognize the need for independence of methodology and the legitimate and beneficial reasons for which ESG ratings or data products may vary between Providers, reflecting differing perspectives and views taken on ESG priorities. While ESG ratings and data products are not generally used in a manner that is strictly comparable to more established financial risk ratings (including credit ratings), similar fundamental expectations around integrity and transparency should be encouraged for both. In addition, **some of the recognized good practices that have developed in the case of the credit ratings assessment process could be reviewed and potentially applied to the ESG ratings process**, for example measures taken to increase transparency and independence of methodologies, and in relation to data quality, commercial policy and effective engagement with Covered Entities.

4.1 Recommendation for IOSCO and IOSCO Members (Recommendation 1)

The IIF and its members support the proposed Recommendation for IOSCO and IOSCO Members to consider focusing attention on the use of ESG ratings and data products, and the Providers of these products in their jurisdictions. However, there are a number of considerations that should be reflected in the final Recommendation and supporting statements, including practical suggestions for the formulation of common approaches, differences in Providers' business models, the potential for market-led efforts, and links to the broader financial sector policy framework.

High-level guidance from IOSCO on how regulators should practically take initial steps in this area can serve as the basis for a set of common approaches for Providers, Users, and Covered Entities. IOSCO could consider augmenting this Recommendation with more detail around the types of minimum safeguards that could be applied as foundations for common approaches, including on topics such as:

- i) **Transparency** on the scope, coverage, data collection processes, and functions of various ESG ratings, data products, or other products, to the extent needed for both Users and Covered Entities to be able to determine the basis for a rating, the sources of data, the frequency with which the information is updated, and other aspects that are necessary to evaluate the quality and appropriate use of ESG ratings or data;
- ii) The relationship of ESG ratings and data products to **other relevant policy frameworks**, including disclosure; and
- iii) **Commercial practices**, given increasing integration in this market, as discussed above.

An important issue identified by IOSCO in the consultation is the need for approaches to be relevant and tailored to the broad range of products, services, and business models that make up the ESG ratings and data products marketplace, e.g., recognizing that certain issues that may be relevant in the context of ESG ratings may not be as relevant for different types of data products, and vice versa.

In addition to the range of products and services, there are a variety of use cases for ESG ratings and data, each of which may merit different policy considerations and approaches. As an example, one growing use of ESG ratings is as an input to counterparty

selection, in a manner similar to the use of credit ratings.⁹ As another example, many asset managers use ESG ratings and data as an alternative data set within their research processes. In this case, market participants are using ESG ratings and data in a manner similar to sell-side analyst research reports – not similar to credit ratings. The variety of potential use cases for ESG ratings and data imply different policy considerations, and a one-size-fits-all approach will not be effective across the entire spectrum. Further, it is not currently clear how different use cases should be considered in the context of the existing regulatory framework.

To respond to this issue, IOSCO could consider developing a clear classification framework for ESG ratings and data products, and associated use cases, which would ideally cover the entire universe of products and services and types of uses. This classification framework could provide a helpful basis for self-regulatory efforts within the market, as well as ensure that any potential future jurisdictional policy responses reflect a common understanding of the distinctions between various products, Providers, and uses of ESG ratings and data. The IIF and its members stand ready to contribute to any initiative to develop such a classification framework.

In addition, **anything that IOSCO and its members can do to encourage and support broader coverage in the ESG ratings and data product market - geographically and in terms of smaller institutions - would benefit Users**, who currently face limitations in the availability and quality of ESG data for less analyzed markets and counterparties. Approaches at the international and regional levels that support broader ESG disclosures for corporate issuers is likely to be an important step in this regard.

In general, the IIF and its members consider that the market-led development of industry standards and codes of conduct for the market for ESG ratings and data products would be highly beneficial at this time. We would support IOSCO and IOSCO members' encouragement for the development of such initiatives. Further views on potential models for industry standards and codes of conduct are provided in the response to the Recommendations for Providers below.

Further, IOSCO members should be encouraged to engage proactively with the relevant prudential authorities and policymakers in their jurisdictions to **ensure that the use of ESG ratings and data is not directly or indirectly required in regulatory or supervisory frameworks** (e.g., for disclosure, risk management, product construction, or scenario analysis) **without a strong understanding of the intended uses and limitations of those products.** Similarly, IOSCO could monitor this topic in conjunction with other global standard-setting bodies such as the Basel Committee on Banking Supervision (BCBS) and the International Association of Insurance Supervisors (IAIS).

⁹ To note, using ESG ratings as a criterion for selection of potential counterparties has the potential to negatively affect market liquidity and financial stability. If market participants can only select counterparties that have a certain ESG rating, this could potentially limit access to liquidity, which could generate financial risks particularly during times of stress. A firm's credit score could then be impacted as a result of clients limiting their counterparty selection, leading to broader implications and unintended consequences.

4.2 Recommendations for Providers of ESG Ratings and Data Products (Recommendations 2-6)

The IIF and its members support many aspects of the Recommendations for Providers set out in the consultation document. At a high level, there are three key issues, with embedded tradeoffs, which IOSCO may wish to reflect upon. These include:

- i) The desired balance between **transparency and avoiding commercial sensitivities**, particularly with regard to the product methodologies and sources of data;
- ii) The desired balance between **flexibility** to enable innovation, differing perspectives and independence of methodology, and greater **consistency and comparability** in aspects of approaches taken;
- iii) The balance of focus on issues that stem from the **general state of underlying ESG data**, versus issues that may stem from **Providers' practices** (for example, the extent to which the use of proxies is required due to gaps in corporate ESG disclosures, which introduces more variation in ESG ratings and data products).

Greater transparency and standardization where appropriate (while avoiding sectoral oversimplifications) within the ESG ratings and data products sphere would be beneficial, and could be a 'triple-win' for Users, Covered Entities, and Providers. From a User perspective, transparency and clarity on a Provider's objectives with a product or service, the scope of these products and services, their coverage, frequency of updates, and some aspects of the underlying methodologies are particularly important. Greater clarity would help Users select the right products and services for their intended uses, fully understand any differences in outputs from different Providers, enhance their ability to interpret the outputs, and drive better decision-making. Specific areas that could benefit from greater transparency and standardization in relation to ESG ratings reports include **where data was sourced for all the indicators used as part of an ESG rating/report**. For example, whether it was sourced from company disclosures, directly obtained or calculated, whether and how proxies were used, how recent the data are, and the degree of assurance around the underlying data. In addition, **greater transparency towards Users as well as Covered Entities about the extent to which individual indicators contribute to an assessment** could be helpful, as well as about the weight setting or material issue selection approach for a given industry.

From the perspective of Covered Entities, the industry considers that **greater transparency and clarity on Provider expectations and processes will make it easier for Covered Entities to meet data requests from Providers**, enabling firms to, over time, meet the needs of multiple stakeholder groups. Further, **greater transparency could also contribute to better underlying ESG practices within Covered Entities** given the positive incentive created by the desire to improve an entity's ESG rating or assessment.

For Providers, increased transparency and the associated benefits of greater clarity, greater ability of Users to interpret outputs, and increased confidence in their products and services could be advantageous as long as commercial sensitivities are respected. We see great merits in the development of industry standards in terms of the level of desired Provider transparency on objectives, scope, methodologies and processes that would support greater clarity while also avoiding commercial sensitivities. For example, a common industry

lexicon and/or disclosure template could be developed for use by Providers to describe their products and services.

We expect that the current focus on improving the availability and quality of Covered Entities' disclosures will improve the availability and quality of the data underlying Providers' ESG products, although it will not address some of the other issues discussed above, including product transparency. Over time, efforts to improve ESG disclosures – such as the expected development of International Sustainability Reporting Standards, in conjunction with coordinated regional initiatives and implementations – should lead to systematic improvements in underlying ESG data that is available to the market and supports a higher level of consistency and robustness in ESG ratings and data products. Although there may still be legitimate and beneficial reasons for which ESG ratings or data products may vary between Providers – reflecting differing perspectives and views taken on ESG priorities – higher volumes, better quality and convergence on the raw data being referenced would be part of the solution to some of the current limitations, in conjunction with higher quality dialogue with Covered Entities, increased transparency and greater standardization wherever relevant, for example on the data collection processes.

In light of the above comments, **the actions points under proposed Recommendation 2 to Providers would be very helpful to increase the robustness and transparency of ESG ratings and data products.** For example, the recommendation that Providers disclose any changes to their methodologies or data sources after methodology reviews. In terms of methodological validation, Recommendation 2 suggests that Providers should undertake some form of validation of their methodologies based on historical experience, where available. However, while this would certainly be welcome where possible, **a lack of historical data for key inputs can present a significant challenge to backward-looking model/methodology validation.** For this reason, it may be valuable to explore other sensitivity testing and validation techniques to rigorously assess ESG ratings and data methodologies. Over time, data and experience will build up, which will make future historical validations easier.

The **suggested actions for Providers under Recommendation 3 are also welcomed to support independence and the strict avoidance of any potential conflicts of interest.** In addition to establishing internal control systems, some Providers may wish to disclose information about how they maintain independence of their methodologies and potentially seek independent external verification of their systems and controls.

In addition, **the suggested actions for Providers under Recommendation 5 would help increase clarity in the marketplace for ESG products and services,** allowing users to better discriminate and choose the appropriate Provider and product or service for their specific needs. For example, if Providers publish information such as the ESG issues in focus, the standards to which they assess Covered Entities, and the other items included in Recommendation 5.

As noted above, the formulation of a set of **market-led industry standards and codes of conduct for the ESG ratings and data products marketplace could be an effective way to drive coherence in a dynamic way over time, recognizing the circumstances, phase of maturity and variety of business models at any point.** IOSCO and its membership could

encourage and support such market-led efforts, including through the development of a baseline set of global principles, and continue monitoring of developments and any challenges to assess whether any greater regulatory interventions might be needed in future.

4.3 Recommendation for Users, and for interactions between Providers and Covered Entities (Recommendations 7-10)

From a User perspective, IIF members agree with the importance of conducting due diligence when referring to ESG ratings or data products provided by third-party entities.

One obstacle to this is when there is insufficient transparency or clarity about the inputs or methodologies underlying those products, so greater transparency as proposed under the Recommendations for Providers and greater communication between data Providers and Users would also be helpful here.

From a Covered Entity perspective, financial institutions support the recommendations that would contribute to efficient data gathering processes, greater openness and more structured communication with Providers during the due diligence process, and more transparency on the basis for Providers' ratings of Covered Entities.

In general, it would be reasonable for interactions between Providers and Covered Entities to take place at least on an annual basis, and more frequently in the event of a material change at the Covered Entity or at the request of the Covered Entity. It is important that Covered Entities have the opportunity to review an ESG rating or score before it is communicated to investors to avoid any misinterpretations; this is not common practice at present.

Although some financial institutions have observed progress recently in their engagements with Providers, there is room for Providers to increase engagement with Covered Entities on data points and chosen methodologies.

In some cases, a dedicated analyst and point of contact may not be assigned to a Covered Entity, which limits the iterative dialogue during an assessment and can lead to inaccuracies. Greater engagement with Covered Entities can also lead to more sophisticated assessments accounting for an entity's specificities or technical information, for example about ESG controversies.

As discussed above and in many of our earlier papers and [consultation responses](#) on the topic, **the IIF and its members agree that improving ESG disclosures is imperative to increase the quality of information available to market participants – including ESG ratings and data providers, and financial institutions seeking to undertake due diligence and risk assessments.** In this regard, IOSCO's efforts to support the work of the IFRS Foundation towards the establishment of an International Sustainability Standards Board – and the work being undertaken through IOSCO Work Stream 1 as described in the consultation – are extremely helpful, in conjunction with coordinated regional initiatives and implementations. In the context of the current consultation, **it may be more efficient for IOSCO to continue its participation in those ongoing international efforts rather than introducing separate recommendations about the location of sustainability-related disclosures**, which are currently embedded within Recommendation 10 for Covered Entities.

Thank you for your consideration of these comments. On behalf of the IIF membership, we hope that these global industry perspectives will contribute to your efforts. We would be happy


to discuss any of these matters further and invite you to contact Sonja Gibbs (sgibbs@iif.com) or Andres Portilla (aportilla@iif.com) should you have questions or comments.

Yours Sincerely,

A handwritten signature in black ink that reads "Sonja Gibbs". The signature is written in a cursive style with a large initial 'S'.

Sonja Gibbs

Managing Director and
Head of Sustainable Finance
Institute of International Finance (IIF)

A handwritten signature in black ink that reads "Andrés Portilla". The signature is written in a cursive style with a large initial 'A'.

Andrés Portilla

Managing Director and
Head of Regulatory Affairs
Institute of International Finance (IIF)