Within ESG reporting, ratings are used for comparing companies and entities across ESG metrics

Section focus

	Standards	Ratings	Regulation & Policy
Description	Standards **guide the disclosure of ESG information** (e.g., tons CO_2/yr, Executive Gender Diversity %, etc.) by companies to their investors and **help businesses communicate their impacts**	Ratings **measure companies' performances and/or exposure to ESG risks** (e.g., AAA, C) that may have financial implications and assign them **associated scores**	Regulation **provides mandatory ESG disclosure rules** and legal requirements for companies to operate in a specific region
Example organizations	GRI, SASB, CDSB, IR, TCFD, Science Based Targets, CDP, World Economic Forum, TNFD	Refinitiv, CDP, Sustainalytics, MSCI, S&P Global, ISS ESG	European Commission, U.S. Securities and Exchange Commission, UK Government

Executive summary

ESG ratings

- ESG ratings are constantly evolving through consolidation, especially by financial rating firms branching into ESG and incumbent rating players looking to grow. Commonly used ESG ratings are CDP, MSCI, Sustainalytics, Refinitiv, S&P Global, and ISS ESG.
- MSCI and Sustainalytics are emerging as leading ratings in the ESG reporting
  - Considered two of the largest ratings with strong prevalence among major investment firms, over 13+ equities and fixed income issuers
  - MSCI offers greater level of detail into their analysis compared to other ratings and more transparency than Sustainalytics
  - Sustainalytics offers sector-specific analysis and is looked to as a second-party opinion within the debt market
- Varying methodologies among ESG ratings has resulted in low correlation between scores. Low correlation between scores and financial performance has led to a lack of trust among stakeholders.
- ESG ratings look at ESG performance that may have financial implications and assign them associated scores. However, they are an incomplete way to assess value creation from ESG.
  - Most ESG ratings are over-weighted towards risks and fail to capture positive impacts
  - Good strategies around ESG ratings will focus on metric level improvement rather than solving for rating improvement
- ESG ratings are gaining attention as investors are increasingly using ratings agencies as an outside-in perspective. Coverage of ESG rating agencies is on the rise, especially in North America and Europe

Several ESG rating players have emerged as leaders

Deep dives to follow

Not Exhaustive

CDP

World's most important Environmental score used by 590 investors…

Over US$110 trillion in assets and 200+ large purchasers with over US$5.5 trillion in procurement spend are requesting thousands of companies to disclose their environmental data through CDP

MSCI

World's most used ESG rating by Asset Managers (46 over 50 top AM)

Rates 13K+ issuers (including subsidiaries) linked to more than 650K equity and fixed income securities. Ratings and research are used by over 1.3K institutional investors globally; including 46 of the top 50 asset managers

SUSTAINALYTICS

Most important second-party opinion for sustainable Financing

The first Sustainability-linked-loan was led by Philips in April 2017, Sustainalytics played a critical role in this first deal as the revolving credit facility's (RCF) interest rates were tied to its ESG rating by Sustainalytics

REFINITIV

Most comprehensive ESG databases in the industry

Covering over 70% of the global market cap, across more than 450 different ESG metrics, with history dating back to 2002. Refinitiv ESG scores are designed to transparent and objective in how they measure ESG impact and pull from over 9K company data points.

S&P Global

1st global sustainability benchmark since 1999

The indices serve as benchmarks for investors who integrate sustainability considerations into their portfolios, and provide an effective engagement platform for investors who wish to encourage companies to improve their corporate sustainability practices

ISS ESG

Global ESG Index provider focused on Governance

ISS ESG is a leading source for sustainable and responsible investment solutions. ISS ESG develops indices and collaborates with global index providers to create innovative solutions based on high-quality, reliable, and relevant ESG data

Additional ESG rating organization is SBTi (Science Based Targets Initiative): 1K+ companies worldwide are leading in zero-carbon transition by setting emissions reduction targets grounded in climate science through SBTi. Independently assesses and approves environmental targets in line with strict criteria

Source: Press release, McKinsey analysis

MSCI and Sustainalytics are emerging leaders in ESG reporting

	Strengths of ESG rating	Key limitations
CDP	• Widest coverage and largest amount of company data • Viewed as high quality and very useful by investors and experts	• Limited to E-related rating topics: climate change, water, forests • Based on voluntary disclosures data
MSCI	• Used by investors including BlackRock, Credit Suisse SM, Vanguard, etc. with a total AUM of +$69B • Favored by investors for its broad coverage, complimentary qualitative report, and identification of leaders and laggards • AI-based algorithm • ESG Investing UK's runner up for 2022 "Best ESG Rating Provider"	• Risk-based approach • No differentiation among sectors • Transparency could improve • Lowest correlations to other ESG ratings
SUSTAINALYTICS	• Used by BlackRock and Vanguard with a total AUM of +$47B • Favored by investors for its broad coverage and high usability • Considers sector-specific factors and unpredictable risks • Strong prevalence - ESG Investing UK's "Best ESG Rating Provider" in 2022	• Risk-based approach • Limited transparency on metrics and methodology
REFINITIV	• Rating cycle: weekly vs. annually • Historical data for ~1K companies as far back as 2002	• Regularly re-addresses metrics resulting in inconsistent metrics across time
S&P Global	• Regarded as high quality by investors and experts • Better serves companies new to ESG	• Methodology isn't transparent - limited access to data • Lack of coverage of DJSI • Limited to self-reporting questionnaire & public companies • Normalized industry scores (can not compare cross-sector)
ISS ESG	• Looked to for governance scoring by investors, and ISS-Ethix on a lesser note	• Has been criticized as being "too strict" by investors • Risk-based approach • Low transparency on KPIs and rated companies

Source: Rating agencies' websites,, Harvard la School's *Managing ESG Data and Rating Risk,* Rate the Raters 2020 Report, ESG Investing "Winners & Finalists 2022"

Sustainability ratings players focus on reporting broad ESG topics to investors

Simplified view **Not Exhaustive**

Sustainability Reporting

Scope of ESG Reporting

Scope of ESG Reporting	Narrow *Investors*	Broad *Multiple Stakeholders*
Broad *Sustainable development goal; corporate social responsibility environmental, social and governance*	SUSTAINALYTICS, ISS ESG, MSCI, REFINITIV, S&P Global	E.g., EcoVadis
Narrow *Climate / Environment*	E.g., Climate Bonds Initiative	CDP, SCIENCE BASED TARGETS

Audience

Environmental, social, and governance ratings
Financial rating agencies measuring quality of ESG disclosures and ESG-related risk

Supplier ratings
Assesses corporate performance along a wider set of topics, including E & S

Climate Bonds
Organizations that certifies green bonds

“Paris-compliant” targets and performance
Issues bonds for projects that align with greenhouse gas emissions

Source: Team Analysis; Expert interviews; documents of each reporting standard/framework, HBR “Designing Your Company’s Sustainability Report”

Each of the major ESG ranking agencies approach ranking differently

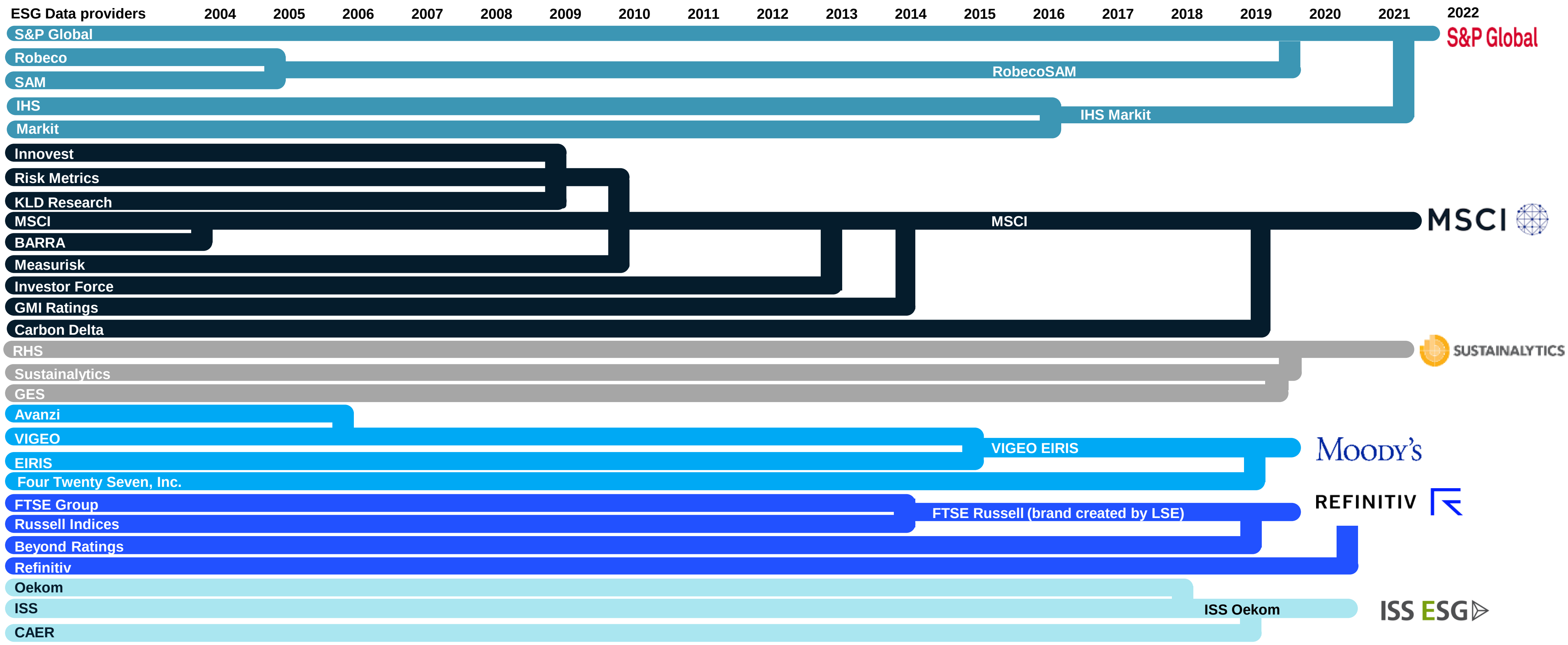
	MSCI	CDP	ISS ESG	REFINITIV	SUSTAINALYTICS	S&P Global
Rating scale	AAA (best) – CCC Scoring relative to peers	A (best) –F (refusal to answer)	1 (best) -10	0-100 (best) & D- to A+ (best)	0-100 (best)	0-100 (best)
Sectorial approach	Cross-sector methodology with normalization, 158 sectors	Tailored approach, 12 sectors	Tailored approach, 40 sectors	1Tailored approach, 10 sectors	Tailored approach, 40 sectors	Tailored approach, 61 sectors,
Main evaluation driver	**Risk-based,** active management of ESG risks	Transparency and performance	Risks management	Transparency and data-driven	**Risk-based assessment,** exposure to unmanaged risks	**Impact,** corporate sustainability ESG performance
Industry relevance	Industry-specific weighting	Industry-specific questionnaire	Industry-specific	Industry-specific weighting	Industry-specific criteria	Industry-specific criteria and weighting
Methodology & limitations description	Outside-in, AI-based assessment using 7,000+ datapoints, metrics, and online screening of controversies. Adjustments by MSCI analysts. AA and above included in MSCI ESG Index. Extensive evaluation (650,000+ securities globally) from multiple sources. No differentiation among sectors.	Climate change (limited S or G) questionnaire updated annually Supplemental focus on financial sector pushing institutions to engage with stakeholders. Rate justified by disclosure of answer and by quality and depth of the answer. "STAR"[1] approach for case studies.	Decile-based score indicating company's governance risk in reference to index or region. Overall valuation based on 12-levels grading system. Advised by a Methodology Board and updated issues included in ESG rankings. Low transparency on KPIs and rated companies. Customizable ratings.	Analyst update ESG database with information pulled from public company records. Types of data considered: Boolean data, numerical data, categorical scoring, benchmarking. Considers 23 ESG "controversial" topics. Historical data for ~1000 companies as far back as 2002. Updates data weekly. Regularly re-addresses metrics - resulting in inconsistent metrics across time.	Focuses on ESG risks, providing a quantitative rate which correspond to five risk levels. Outside-in algorithm-based assessment on industry ESG risk exposure based on up to 1500+ ESG datapoints and metrics, including controversies. Reviewed and validated by SAM analyst. Takes into account sector specific and unpredictable risks. Limited transparency on metrics and methodology.	Invitation-only, eligibility screen based on qualitative media coverage and public stakeholder information. Evaluation based on a quantitative inside-out assessment via questionnaire with approx. 100 questions to be filled by the company. Reviewed and validated by analyst. Looks for evidence of having identified material sustainability issues and of implementation of strategies to address them
Coverage and application	~8,500 companies, global ~14k equity/fixed income issuers Equity market (serving 46 out of 50 largest asset managers) Evaluation of countries, industry leaders, mutual funds and ETFs Supplies MSCI & bloomberg indices	~14,000 (No. companies that disclosed via CDP in 2021 globally) Tailored towards investors and other in the financial industry Supplies Euronext, STOXX indices	~9,600 corporate issuers Offer several solutions within the ESG space Fund managers pay ISS to advise (and often vote their shares) regarding shareholder votes Supplies Solactive & STOXX indices *Apart of Deutsche Borse Group*	~9,500 companies, global ~500+ companies ranked Supplies Refinitiv indices *Apart of London Stock Exchange Group*	~40,000 companies, global Debt market (most widely used for second-party opinion on green bonds and sustainability-related financial instruments) Serves investors and other in financial markets Supplies Solactive, STOXX, S&P indices *Apart of Morningstar*	~10,000 companies rated, global Equity market (DJSI) Limited to public companies Normalized industry scores (can not compare cross-sector)

1. STAR= Situation - Task - Action - Result

Source: Rating agencies' websites, and meta documents, ESG Navigator's *ABCs of ESG Frameworks and Ratings,* Harvard la School's *Managing ESG Data and Rating Risk,* Investments and Wealths' *No Place to Hide Thanks to Morningstar, Bloomberg, MSCI, and Multiple Global Data Providers*

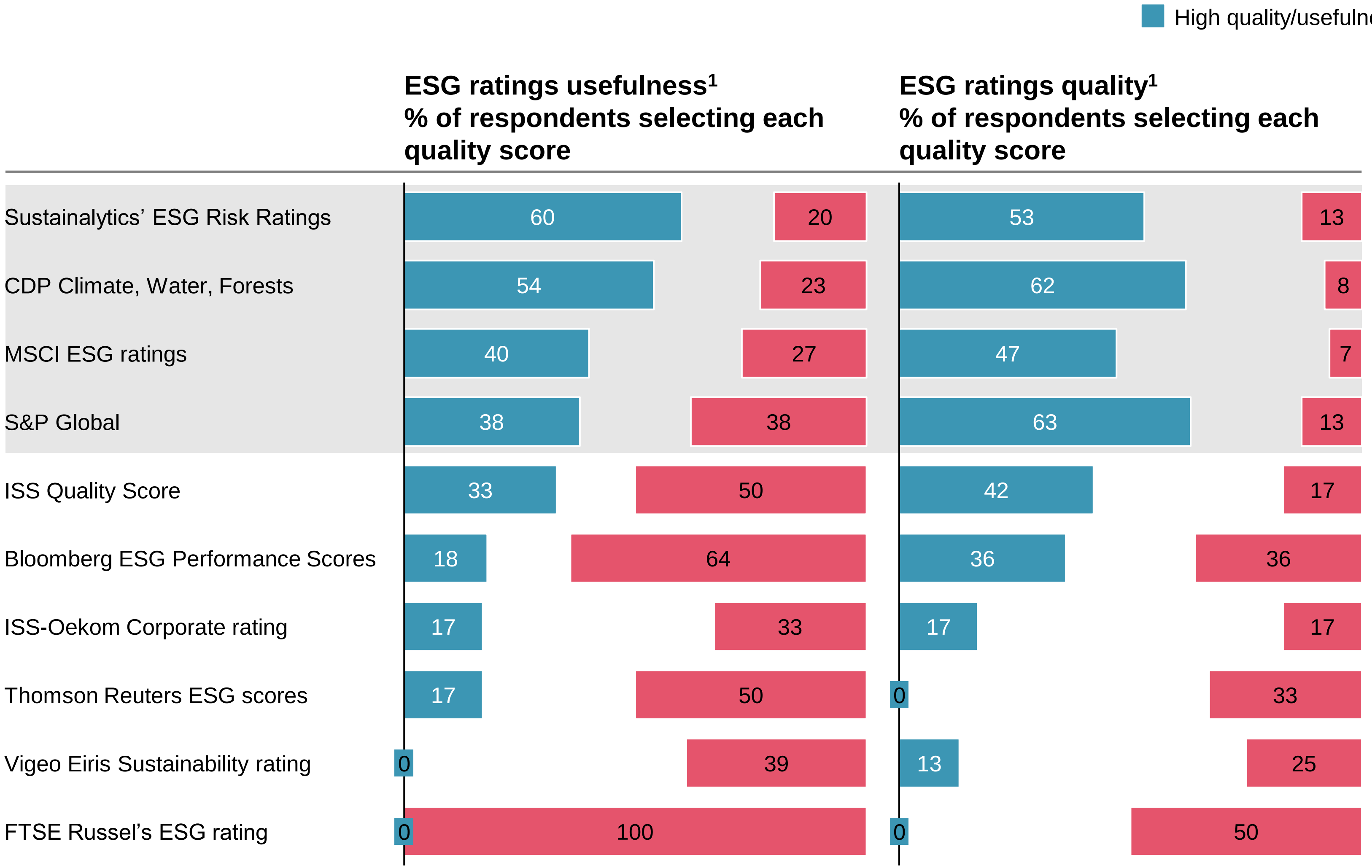
The ESG rating industry is progressively consolidating, with entrance of big data and rating agencies

Not Exhaustive



Source: Press releases

Quality and usefulness of ESG ratings is not widely accepted



Rate the Raters expert interview insights

SUSTAINALYTICS

Stronger on core sustainable performance in the classical sense

More transparent, but has a lot of instances where they are missing pieces of the analysis

CDP

We've found most useful the underlying performance data, we use emissions data directly, we don't use the scoring

Data tends to be spotty because not a whole lot of companies report on CDP

MSCI

[We combine ratings] 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

S&P Global

The methodology isn't transparent; no one knows what's behind it

It occupies a position in corporate sphere where it has high profile but it's tiny in impacting any investing decision-making

1. Investor's perspective

Source: Sustainability: Rate the raters report 2020

CDP, SAM, Sustainalytics and MSCI are the top ranking ESG rating agencies, by the “Rate the Raters” report

Not Exhaustive

	Rate the Raters 2020» score[1]	Rating agency methodology / approach
CDP	67	Climate change questionnaire updated annually Supplemental focus on financial sector pushing institutions to engage with stakeholders
S&P Global[2]	66	Eligibility screen based on qualitative media coverage and public stakeholder information Evaluation based on a quantitative assessment
Sustainalytics	54	Focuses on ESG risks, providing a quantitative rate which correspond to five risk levels Takes into account sector specific and unpredictable risks
MSCI	51	Artificial Intelligence based scoring Dedicated team of analysts Evaluation of countries, industry leaders, mutual funds and ETFs
ISS-oekom	42	Overall valuation based on 12-levels grading system ESG threshold for “Prime” status depends on ESG sector relevance
Refinitiv	No data	Refinitiv relies on its standardized ESG data points (450+) and analytics (70+), and stresses the importance of transparency, company disclosure and standards of reporting

Insights from investors on rating agencies

- CDP and ISS were often mentioned for quality and usefulness
- The RobecoSAM CSA was raised by investors as high quality, but less useful for investment research due to limited access to underlying data and analysis
- Sustainalytics and MSCI were most often mentioned by investors for their broad coverage
- ISS is praised most frequently for its governance scoring

About the Rate the Raters report

- SustainAbility puts a score on ESG rating agencies via a survey and interviews conducted with investors
- The exercise incorporated a range of geographies, investor types (pension funds, asset managers, banks), investment approaches (including active and passive), and levels of ESG integration

1. Percentage of surveyed experts considering rating as "high quality" (n = 160 to 245, varying by rating provider) in the Rate the Raters 2020 report
2. Latest Rate the Rater’s provides a review of RobecoSAM, which is apart of S&P

Source: SustainAbility - Rate the Raters 2020 report, Ratings companies’ websites

Weighting of E,S,G topics are non-uniform across sustainability ratings

Banking industry

Environment | Social | Governance

Rating[4]	Environmental weight indicators, %	Social weight indicators, %	Governance & economic weight indicators, %[3]	Is the methodology for final estimation publicly available?	Do you assess the events in which the Company is involved?[2]
S&P Global	13	32	55	✓	✓
REFINITIV	14	50	36	✓	✓
CDP Climate Change Score[1]	100[3]			✓	
MSCI	5	60	35	✓	✓
SUSTAINALYTICS	42	29	29		✓
ISS QualityScore GOVERNANCE			100	✓	✓

1. Also covers climate governance as part of scoring
2. For Refinitiv, ESG combined score is the combination of ESG score and controversies score
3. CDP rates companies based on disclosure and includes governance data
4. Weights are based on Banking for S&P, Banking for Refinitiv, Banking for MSCI. Sustainalytics is an average across all industries (not Banking specific)

Source: S&P Weights 2021, Refinitiv, CDP, MSCI, Sustainalytics, ISS

Variation in the methodology of ESG ratings has led to poor correlation among ESG scores

Main challenges in comparing ESG scores and indexes

Lack of transparency	• No **complete and public information** about criteria and assessment processes • Difficult to make comparison **between ESG rating agencies**
Commensur-ability	• **Lack of consistency:** same concept measured in different ways (e.g., some agencies consider % of women in management as a Governance factor, others as a Social one)
Lack of correlation	• Lack of standardization that leads to: **variance among the ESG scores used by investors and limited correlation** among them (e.g., MSCI and Sustainalytics have a correlation of only 0.53 between their scores)
Materiality/ Criteria balancing	• Not always assigned **same weight to ESG criteria** by all agencies as data providers make their own **determination on materiality** issues • Higher scores in one domain **may compensate** with very low scores in another one

Poor correlation among leading ESG data providers scores

	SUSTAINALYTICS	MSCI	SAM Now a Part of S&P Global
SUSTAINALYTICS	-	0,53	0,66
MSCI		-	0,47
SAM Now a Part of S&P Global			-

ESG data providers' correlation is ~0.61[1] while traditional rating agencies are correlated by 0.95+[2]

Poor correlation in ratings harms the market

Correlation among agencies' ESG ratings was on average 0.61; by comparison, credit ratings from Moody's and Standard & Poor's are correlated at 0.99 – the consequences of this are –

- **Corporate stock and bond prices unlikely to reflect ESG performance** as investors struggle to accurately identify out-performers and laggards
- **Dampened ambition of companies seeking to improve their ESG performance**, thanks to the mixed signals about which actions are expected and will be valued by the market

1. MIT study, 2019 considering 5 rating agencies
2. 0.99 correlation between Moody's and S&P, MIT study 2019

Source: MIT, team analysis

Ratings agencies are measuring the same attribute using different indictors contributing to divergence

xx% Relative importance in differentiation

Ratings differentiation is due to different scopes, weights used and methods employed by different agencies

Weight divergence	13%	Assign varying degrees of importance to attributes
Scope divergence	37%	Include or exclude different measures as "ESG" is not fixed
Measurement divergence	50%	Measure the same attribute using different indicators

A **"rater effect" has also been identified** — ratings agencies' assessment of a company in individual categories seemed to influence their views of the company as a whole. I.e. a positive score in one area seems to correlate with a positive score overall

Data access – many ratings companies will not have full access to data as companies do not measure or publish consistent information - some may try to find proxies if they don't have access to data.

Source: "Aggregate Confusion: The Divergence of ESG Ratings," – MIT 2019 – covering five prominent agencies around the globe – KLD, Sustainalytics, Video-Eiris, Asset4, and SAM (S&P)

Company and industry performance varies widely across different ratings

Oil & gas industry, 2020-2021

Outside-in Assessment **Illustrative**

Not rated | Leader | Median | Laggard

Geography	Company	Overall ESG: S&P Global	Overall ESG: REFINITIV	Environment: CDP Climate Change Score	Environment: CDP Water Security Score	Risk & Resilience: MSCI	Risk & Resilience: SUSTAINALYTICS	Gover-nance: ISS QualityScore GOVERNANCE	EV/ EBITDA NTM
North America	Chevron	40	B	F	F	BBB	40.3	4	8.3
	ExxonMobil	37	C	F	F	BBB	32.3	4	8.5
Asia & Middle East	PetroChina	20	B	D-	F	CCC	56.4	4	5.7
	أرامكو السعودية Saudi Aramco	N/A	C+	N/A	N/A	BB	51.0	N/A	8.8
	Sinopec	29	B	F	F	B	51.7	9	4.8
Europe	bp	49	C+	F[1]	F	BBB	37.4	4	6.1
	eni	44	C+	A-	A-	A	25.7	7	4.5
	equinor	47	C+	B	F	AAA	33.5	4	4.2
	ROSNEFT	40	A-	C	B-	BB	39.8	6	4.3
	Shell	66	C+	B	F	A	35.8	1	5.3
	TOTAL	72	C+	A-	A-	A	27.0	3	6.8
Scale		0-100 Highest best	0-100 Highest best	A –F A best F = refusal to answer		AAA - CCC AAA best	0-100 Lowest best	1-10 Lowest best	**1-100 Highest best**

Insights

Overall, the industry performs average to poorly by most ESG raters

Eni and Total performs better than peers due to their extensive reporting and climate action. They are followed by Equinor, Shell, and Rosneft

Companies in Asia tend to perform worse compared to their Americas and Europe peers

Source: Ratings websites