ESG data and ratings providers: introduction

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An introduction to environmental, social and governance (ESG) data reporting and ratings providers. This note looks at three main types of product: ESG scoring, due diligence assessment and performance tracking.

Scope of this note

This note provides an introduction to environmental, social and governance (ESG) data reporting and ratings providers. It explains the roles of the three main categories of ratings and reporting providers: ESG scoring, due diligence assessment and performance tracking. It summarises how these are used in practice and the challenges. The note also highlights some of the key providers in each category.

For information on the emerging regulation of ESG data and ratings providers, see *Practice notes, Future UK regulation of ESG data and rating providers* and *Future EU regulation of ESG data and rating providers*.

For background information, see:

- *Practice note, Environmental, social and governance (ESG): an introduction*.
- *Environmental, social and governance (ESG) toolkit: UK*.

ESG data

In the past, investment decisions were largely based on financial indicators, in relation to both the historical performance and the forward prospects of a business. Tried and tested evaluation methodologies were used with a primary focus on the financial return of an investment over time. However, initially through prominent voices in the financial sector, environmental issues such as climate change, followed by broader social and governance risk topics have now become material considerations in investment due diligence and risk analysis processes.

The rapid increase in the popularity and importance of ESG information in investment decisions has led to a growing need for recording and collecting ESG data. While ESG initially developed primarily in the investment community, most sectors impacted by financial institutions are now increasingly considering ESG in their strategy, operations and marketing. Corporations, law firms, business advisory firms, consultancies and regulators all have a stake in ESG matters and therefore need to access data and reporting solutions.

ESG data can be broadly broken down into four different categories, depending on its application and availability:

- **Data that is collected and disclosed by individual companies in relation to their own operations, some of which will be publicly available.** Generally, this data might be available via public disclosure requirements for publicly

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traded companies (see *Climate-related and environmental disclosures toolkit*). Other companies may voluntarily publish sustainability performance metrics or key performance indicators (KPIs) to showcase their ESG credentials, including using third-party verification schemes and certifications such as B-Corp (see *Practice note, Climate-related and environmental disclosures: guidance and voluntary reporting frameworks*).

- **Data on companies that is collected and presented by third parties, including non-governmental organisations (NGOs) and regulators.** Data from regulators is available in national compliance databases for risk topics such as health and safety and pollution monitoring, alongside other data from organisations like the *Business and Human Rights Resource Centre*. Data from NGOs and pressure groups is usually focused on issues that may have an adverse reputational impact on a company, such as pollution incidents or operations that have had an adverse impact on ecosystems or communities.

- **Data on industry or sector-level risk topics (rather than on individual companies).** This would include, for example, data developed by standards organisations, such as the Sustainability Accounting Standards Board (SASB) Standards (see *SASB: Standards overview*) or the Global Real Estate Sustainability Benchmark (GRESB) (see *Global ESG Benchmark for Real Assets*).

- **Geographical data relating to issues that are highly specific to a region.** This would include, for example, data relating to risks of conflict and security, deforestation or child labour. There are a several global databases which, when used together, can provide an overview of the likely issues that will be important to a company that operates globally. An example is the Children's Rights Atlas published by UNICEF, which can be used to assess the status of child labour for any given country (see *UNICEF: Children's Rights Atlas*). Once overlaid against industries with a high prevalence of child labour (such as the apparel sector), this can be utilised to focus diligence activity.

ESG reporting standards and frameworks

Several global standards have been developed to provide objectivity when assessing a company or financial product (such as an investment fund) against ESG criteria.

The principal objective of ESG reporting standards is to provide a comparative and consistent framework that can be replicated and implemented across different business activities. It is widely accepted that some form of standardisation in ESG reporting is crucial to provide objectivity and extract meaningful and comparative data. Without ESG standards, companies could cherry pick the data that it most suits them to disclose and greenwashing can proliferate, both intentionally and unintentionally. Greenwashing arises where products (including financial products) are marketed as sustainable when in fact they do not meet basic sustainability standards. Regulators globally are increasing their focus on preventing greenwashing.

For more information, see Practice notes:

- *Greenwashing in advertising and consumer protection law*.

- *Hot topics: UK regulation of sustainable finance*.

- *Hot topics: EU regulation of sustainable finance*.

A further key development in this area is the consolidation of some of the major ESG standards organisations and frameworks, to address the proliferation of standards. In particular, the International Sustainability Standards Board (ISSB), which was established by the International Financial Reporting Standards Foundation, is developing global sustainability disclosure standards aligned with the financial reporting standards set by the International Accounting Standards Board (IASB).

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For information on development of the ISSB standards and its consolidation with other standard-setting organisations, see *Practice note, Climate-related and environmental disclosures: guidance and voluntary reporting frameworks: ISSB developing global sustainability standards*.

For information on the key sustainability standards and reporting frameworks available, see *Practice notes, Guidance on climate-related and environmental disclosures: quick reference guide* and *Climate-related and environmental disclosures: guidance and voluntary reporting frameworks*.

ESG ratings and data providers

Given the importance of ESG data to many investors and other stakeholders, service providers who can provide ESG data and ratings are seeing growing demand for their services and are becoming increasingly active in the market.

ESG rating and data reporting providers largely fall into three main categories: ESG scoring, due diligence assessment provision and performance tracking. There is considerable overlap between these areas and many ratings and reporting providers are seeking to provide full lifecycle solutions in the ESG space. Each of these distinct areas, however, fulfils specific requirements for stakeholders and practitioners.

Emerging regulation of ESG data and ratings providers

Given the growing focus on ESG issues from investors, ESG ratings and similar products have become increasingly popular for investors to compare companies' ESG credentials. However, this popularity has led to concern from some market participants and regulators about the consistency and quality of ESG ratings, as well as the ability to compare ESG ratings from different providers who often use materially different methodologies.

For information on the developing regulation of ESG data and ratings providers, see *Practice notes, Future UK regulation of ESG data and rating providers* and *Future EU regulation of ESG data and rating providers*.

ESG ratings and scoring providers

Examples of providers

The main function of these providers is to provide an overall ESG score for companies. These providers tend to focus on publicly listed companies. The purpose of the score is to enable an investor to consider the ESG performance of a company when looking to make an investment. Information and data are generally captured from financial and, increasingly, non-financial disclosures. Some of the most active ESG rating providers currently operating in the market are Morgan Stanley Capital International (MSCI), S&P Global ESG Scores, Sustainalytics and EcoVadis.

Sustainalytics' ESG risk rating

Sustainaltyics was created to identify and understand financially material ESG risks. Unlike other rating providers where the final output reflects the company's overall ESG performance, the Sustainalytics' ESG risk rating measures the level of **unmanaged risk**.

Sustainaltyics uses a two-dimensional approach, which involves looking at exposure and management of ESG issues. It generates automated analysis of ESG reports using natural language processing. The methodology covers 20 material issues and uses 300 ESG indicators and over 1,300 data points, with up to ten issues listed per company.

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Morgan Stanley Capital International (MSCI)

MSCI is a global investment research firm that provides software solutions and tools to assist investors with the decision-making process, including multi-asset portfolio analysis, index regulation and ESG-related products. MSCI's ESG rating was created to highlight and measure a company's exposure to ESG risks and opportunities and assess how well the company manages these risks compared to competitors and peers. Data is gathered by analysing publicly available reporting and propriety ESG data. Data covers 35 key issues, with six to ten identified per industry. MSCI's approach to materiality focuses on industries and uses modelling to provide an average value per industry.

Fitch ESG ratings

Fitch ESG ratings product for investors is another example of a ratings provider that has developed its own ratings and data analysis products to compare ESG performance, impact and outcomes. Sustainable Fitch ESG scores consist of two stand-alone scores: an ESG entity score (ESG ES) and an ESG framework score. The ratings methodology is aligned to ESG taxonomies, principles and reporting standards, including the *EU Taxonomy Regulation ((EU) 2020/852)* and the *Sustainable Finance Disclosure Regulation ((EU) 2019/2088)* (SFDR) (see *Practice notes, Sustainable finance: EU Taxonomy Regulation: overview* and *Sustainable finance: EU SFDR: overview*). The ESG ratings are driven by human analysis with quality control processes, including committee decision-making and verification of ratings. The ratings are monitored and subject to an annual review, as a minimum, or following significant events.

Bloomberg ESG disclosures

Bloomberg's proprietary and third-party ESG scores provide investors with an evaluation tool covering disclosure and performance and to benchmark activities. Data is captured from publicly available documents, primarily annual reports, sustainability reports, stewardship or corporate governance reports, websites (including published statements) and policy documents.

ESG ratings and scoring in practice

Ratings and scores allow investors and practitioners to compare risks across different sectors using a huge range of resources fed by disclosures directly from companies, along with information from annual reports, third-party research and various indices. Ratings can facilitate the task of evaluating publicly listed companies, given the breadth of data and information available from mandatory financial and non-financial disclosures and investor requirements. However, sorting through the data and using a systematic and reliable approach presents some difficulties. For example, companies may report against a number of different ESG disclosure frameworks, which can make comparison difficult. In addition, what a company may consider to be material for its operations may differ from what is material from an investor's perspective. This can lead to good availability of data and information that promotes the company's ESG credentials, but a lack of data on areas of underperformance, or where the company is reluctant to publish.

Unlisted companies will often be even harder to assess due to a lack of available information. However, some ESG rating and scoring providers also collect the data of unlisted companies through direct questioning of companies. The growing demand for ESG data from a variety of stakeholders has increasingly led to private companies responding to such queries. In addition, as ESG management has become more integrated into company risk management, private companies are increasingly seeking third-party certification and verification of data or alignment to certain sustainability targets. Companies may also see a benefit in marketing their ESG credentials by publishing materiality assessments and associated KPIs not just as a way to inform potential investors but also to show consumers and customers that they are serious about ESG issues.

Ratings and scoring solutions can be used for gap analysis to understand a company's ESG operations and industry specific best practice (for example, as part of due diligence or when managing a portfolio). This can save costs and time by reducing the amount of resource needed for gathering and comparing information on a large number of companies.

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Challenges with using ESG rating and scoring solutions

Different providers vary considerably in their ESG scoring, weighting and approaches to methodology. This is not surprising given the breadth of subjects covered by ESG (scope) and the considerable range of performance indicators (measurement) and how factors are weighted (weighting). For example, how do you score a metric on biodiversity against one on workplace conditions? In addition, the data used may be partly based on subjective assumptions or may not be independently verified.

Investors have expressed concerns about data inaccuracies and ratings or scores that focus on previous performance rather than looking forward. The sheer volume of available options of ratings providers can also be overwhelming for those looking for clear and concise tools and solutions to ESG evaluation. As data availability and accuracy improves, along with the evolution of standards and regulations, it is anticipated that best practice will improve and solidify approaches by ratings providers. It is also likely that the quality and quantity of data and ESG information on private companies will improve.

Due diligence assessment providers

ESG due diligence assessments can be a key tool in appraising a company's ESG status and are increasingly being used for corporate acquisitions, mergers, and investments. The assessment should evaluate both the risks and the opportunities across the sustainability and social risk criteria that are relevant to the target and the investor.

Examples of tools

Risk Horizon

Risk Horizon is a product offered by a UK company, Landmark Information Group. It provides ESG due diligence reports, primarily for private companies. Reports are prepared by a Landmark ESG specialist using the Risk Horizon software platform, supplemented by online searches. The platform is based on the SASB materiality map, which identifies key risks for 77 industry types. The platform identifies the key material ESG risks for the company being considered, based on its industry sector and operating locations.

These surfaced risks are then checked against over 45 global databases (including from the World Bank, UNICEF and others), from which key issues are identified and scored. For example, a mining company will have several ESG risks identified by SASB, one of which is tailings storage management. The platform then interrogates the relevant global data set, in this case data from the Global Tailings Portal. From this, a score is produced depending on the country. For example, a mining company with operations in Brazil would be considered a high risk due to the country ranking across relevant parameters, including consequence of failure and number of facilities.

The platform also produces two levels of ESG due diligence questions, which cover reputational and operational issues. The Landmark consultant researches the questions, following a prescribed methodology using internet searches, analysis of external databases and information that may be available directly from the target company. The report provides an overall risk profile rating.

Risk Horizon also offers a more detailed assessment report, which produces an ESG maturity score for benchmarking company performance.

RepRisk

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RepRisk is based in Zurich and provides ESG due diligence on global companies. It bases its assessment on several standards, including SASB. RepRisk uses artificial intelligence (AI) advanced machine learning and its consultants to identify material ESG risks in relation to companies, real assets and countries.

RepRisk deliberately does not use reports and information produced by the target company and instead focuses on external information sources, including social media and government bodies, to build a risk profile of a company.

RepRisk provides various products including a risk platform, datasets and metrics, and a data feed, as well as reporting and monitoring in 23 languages.

ESG Fusion

ESG Fusion is an on-demand report platform provided by Environmental Resources Management (ERM). It uses AI to provide a comprehensive assessment of a company's ESG risks and opportunities. It has 15 ESG topics, 60 material risk and 90 management maturity indicators, all of which have been created by ERM. Information is primarily obtained from the internet and uses ERM's SmartFetch technology, which consists of automated web crawlers supplemented by several data providers and curated by analysts. The platform also provides portfolio monitoring and ESG benchmarking.

Control Risks

Control Risks is a global risk consultancy that specialises in strategic consulting on political and security risks. ESG country monitor is a subscription-based service that provides ratings and country narrative that identify key potential ESG risks relating to new investments and projects.

ESG due diligence in practice

A key issue for law firms when undertaking ESG due diligence in the context of an acquisition is access to credible and accurate data and information. Consultants can provide two main levels of ESG due diligence:

- **Initial due diligence assessments.** These assessments play a crucial role in allowing law firms to understand the potential ESG issues for a client and their investment throughout the stages of a transaction. Pre-due diligence screening consists of reviewing publicly available information (including company disclosures, published statements and policies alongside external data sources such as regulators and the media). This allows consultants and lawyers to highlight any red flags and headlines about a target and draw up an initial risk rating or overview. It also helps frame the key issues and set the parameters for further consulting on specific issues.
- **More detailed performance or maturity reviews by consultants.** These reviews can supplement due diligence questionnaires deployed by law firms. This level of assessment can provide more detail on the strengths and weaknesses of a company's approach to ESG management. For example, a detailed checklist with corresponding score will be suitable for gap analysis and understanding whether key policies or mitigation measures might be missing from a company's management approach. This level of report is also suitable when considering different types of transaction, such as divesting business segments or companies from a wider group structure.

One of the key elements of ESG diligence is also the consideration of reputational issues, which by nature are harder to define with metrics and ratings. Such issues can have hugely significant impacts on a business, not just from an investment perspective but in terms of operations and customer impact.

Performance trackers

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Examples of providers

The final group of providers track performance and allow metric collection and KPIs to be set.

Worldfavour

Worldfavour is a Swedish consulting and IT services firm that has developed a sustainability management and reporting platform tool to cover sustainable sourcing, investments, supply chain visibility and sustainability management. The platform provides tools for setting and measuring sustainability goals and performance within an organisation, as well as digitising data collection. Global frameworks can be customised for users and can be aligned with international guidelines, matching them with material topics. This allows platform users to benchmark progress against frameworks such as the UN sustainable development goals (SDGs) or the Task Force on Climate-related Financial Disclosures (TCFD) (see *Practice note, Task Force on Climate-related Financial Disclosures (TCFD): recommendations for disclosing climate-related financial information: overview*).

Ecodesk

Ecodesk provides a cloud-based data platform solution designed to enable companies to track, monitor and report their ESG data with a focus on supply chains. Their products support in-house operations, management systems and reporting outputs, using checklists and customisable questionnaires.

Reporting 21

Reporting 21 offers an ESG software platform and advisory service. It specialises in data management, performance metrics, reporting and analytics, KPI monitoring and customising ESG reporting.

Performance trackers in practice

ESG performance trackers tend to be useful for fund managers or investors with a portfolio of businesses or for those managing their supply chain. Tracking performance from acquisition through to exit can demonstrate value and improvement against ESG metrics, which in turn may be viewed favourably when combined with financial performance.

Increasingly, firms are using more sophisticated software to manage their ESG requirements. Some providers have developed full lifecycle management solutions that incorporate scoring and ratings, due diligence and performance tracking either in a single module or within a package of modules. These tools can also be used at a company level to communicate ESG performance milestones in annual corporate reports or for tracking progress towards regulatory or voluntary targets, such as net zero commitments or other strategic targets.

Performance trackers are primarily used to:

- Assess and manage the ESG performance of a portfolio of companies by investors.
- Support accurate data collection and reduce the risk of greenwashing.
- Support setting and tracking ESG goals and targets.

Analysis of trends

As the demand for ESG ratings and data services continues to increase, privately developed ESG assessment and standards are becoming the subject of public regulatory oversight. This is happening on both sides of the Atlantic, as evidenced by the

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US Securities and Exchange Commission's ESG and climate disclosure requirements for companies and the EU's Corporate Sustainability Reporting Directive (CSRD). The former places greater demands on US companies, which have so far enjoyed freedom to decide what to disclose, subject only to the demands of materiality. In the EU, the CSRD brings a new level of detail to existing non-financial disclosures over a wide range of sustainability issues.

In both jurisdictions, the changes reflect wider shifts in the political economy as signalled, in the US, by the push for a green economy in the Inflation Reduction Act. In Europe, the Commission Communication on the European Green Deal emphasises green investment, thereby supporting calls for clear and identifiable sustainability criteria to drive investment. These are important developments as they signal a shift from a voluntary to a compliance culture when addressing ESG disclosures. Some commentators see a risk of voluntary ESG commitment being replaced by box-ticking.

From a regulatory point of view, this move can be described as a move from principles to prescription. In other words, we may in the past have laid down broad demands on corporate entities, such as a requirement to disclose based on materiality, while leaving it to the company to determine precisely what it is that might be material to their business. Principles-based regulation works on the basis that companies are often best placed to know their own business and have the internal expertise to generate and disclose relevant data. This is not confined to the ESG arena. Principles-based regulation is often depicted as a more modern move away from traditional detailed demands of "command and control" structures. Why then would ESG regulation buck this trend? The answer lies in the product of voluntary disclosure systems that suffer from a lack of consistency and comparability in ESG data and a call for a standardised and reliable reporting framework. Nonetheless, some innovative thinking about relevant and robust data has been generated by voluntary initiatives and there may be less room for innovation in more static and fixed prescriptive systems. On the other hand, a prescriptive approach can encourage compliance.

As this shift to more detailed and objective data occurs, the subjective base of ESG ratings may come under pressure. The European Securities and Markets Authority is considering regulating providers of ESG data. It proposes requiring much greater transparency on methodologies employed by providers, particularly in relation to the source of data and the weighting of risk. This is to reduce the dangers of conflicts of interest and greenwashing. The UK Treasury has also mooted possible regulation of providers, potentiallypossibly by the Financial Conduct Authority, to provide more open and comparable data. For more information, see *Practice notes, Future UK regulation of ESG data and rating providers* and *Future EU regulation of ESG data and rating providers*.

This approach might be made to work, not only for ESG data providers but more widely in relation to ESG disclosures, by using "comply or explain" models of regulation. This approach would allow the move to more prescriptive requirements for ESG, within a code of good practice, but with the proviso that compliance can be satisfied by an explanation, by way of disclosure, from the regulated party as to why there has been a departure from the good practice standard. In part this produces a hybrid between voluntary and mandatory approaches, which helps address the risks of each approach as outlined above. An example of this in practice is the Listing Rules' comply and explain requirements for disclosures aligned with the TCFD recommendations (see *Practice note, TCFD recommendations: climate-related financial disclosures for premium listed and standard listed companies (LR 9.8.6R(8) and LR 14.3.27R)*). A similar approach in other areas could help data providers to explain why there is divergence from a standard methodology, or enable companies making ESG disclosures to argue that certain factors beyond the mandated ESG criteria were particularly pertinent for that company.

In the context of ESG data becoming increasingly influential in driving investment decisions, the width of the ESG agenda is somewhat problematic, such that voluntary disclosure systems may open the door to greenwashing. However, in moving to greater consistency and uniformity, there is a danger that, for some companies, criteria which are particularly material to their business are not covered. It is in this context that "comply or explain" models might usefully span harder, mandated and softer, voluntary governance approaches.

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