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ESG Ratings: Senator Toomey Again Writes to ESG Rating Firms on Disclosure of Methodology

November 8, 2022

ESG Ratings

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Last week, U.S. Senate Banking Committee Ranking Member Pat Toomey (R-Pa.) wrote follow-up **letters** to 12 ESG ratings firms requesting that recipients preserve material potentially responsive to requests made in an earlier September 20 letter. According to a **press release** from Senator Toomey, as of November 3, six companies had yet to respond at all or "provided incomplete responses."

In the **September 20 letter**, Senator Toomey requested that the 12 firms share all non-proprietary methodologies used when calculating ESG ratings, "including the specific E, S, and G factors that you measure and how those factors are weighed." He also requested disclosure of sector-specific methodologies, including information on how the scope of industry sectors is determined.

The letter states that "the use of ESG factors in capital allocation has become an issue of increasing bipartisan interest to Congress and regulators," and concludes by stating that "given the above concerns and increased bipartisan interest in conducting oversight of the ESG industry, it is crucial that your firm provide the information I requested on September 20."

Taking the Temperature: As described in detail in our recent Clients & Friends Memo on ESG ratings, U.S. legislators are not the only group finding it challenging to understand how to effectively use ESG ratings, with asset managers and others attempting to wade through ratings from hundreds of providers using a variety of sources of data, methodologies, and formulae to arrive at their ultimate ESG scores. Ratings firms present their data using different scales—some using letter rankings with others providing numerical scores—causing difficulty when trying to perform one-to-one comparisons between ESG ratings firms. Some ratings firms rely solely on publicly available information as their source data, whereas others rely on questionnaires and

feedback from companies directly, which may include material information not otherwise available to the public, in addition to information that is publicly available.

As a result, industry regulation is possible. In the EU, for instance, the European Securities and Market Authority announced that it is considering increased regulation of the ESG ratings sector. In the UK, the Financial Conduct Authority has opined that low correlation among ESG ratings is not, in itself, harmful, as long as ratings providers are transparent about their methodologies and the data they use and have robust governance processes. The Board of the International Organization of Securities Commissions has also published recommendations for ESG ratings providers. The common theme across regulators and industry bodies is a push toward increased transparency. More consistency would benefit investors and companies focused on sustainable initiatives. Another approach might be for ratings providers to unbundle and separately assess companies according to their "E," "S," and "G" policies (some ratings providers, such as S&P, do currently provide disaggregated information), thereby supplying investors with more targeted assessments and, therefore, more useful information. Ultimately, ESG ratings firms can enable consumers of that information to effectively utilize the ratings only by offering greater transparency regarding the inputs to the rankings and how those inputs are assessed and weighed.