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ESG Ratings: Findings on Variation Between ESG Ratings Providers

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ESG Ratings

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The Review of Finance recently published a paper entitled **Aggregate Confusion: The Divergence of ESG Ratings**, which disclosed the findings of an investigation into the "divergence of sustainability ratings." The authors investigated six ESG ratings providers: Kinder, Lydenberg, and Domini (KLD); Sustainalytics; Moody's ESG (Vigeo-Eiris); S&P Global (RobecoSAM); Refinitiv (Asset4); and MSCI. The paper found not only that the ratings providers failed to reach the same conclusion on a company's ESG rating, but also that "in most cases there was little agreement among them" and that "ESG rating divergence is not merely a matter of varying definitions but a fundamental disagreement about the underlying data." The paper was supplemented by a subsequent *Wall Street Journal* **article** written by one of the paper's authors.

The paper offers two reasons for the divergence: "What ESG raters choose to measure, and whether it is measured consistently," which the **authors** respectively term "theorization" and 'commensurability.'" The paper suggests that one method for improving ratings would be for regulators to establish disclosure standards that require "all companies to disclose certain ESG-related data, as the information reported by companies is the main source of data for ratings." They additionally **suggest** that regulators could impose mandatory auditing of ESG data similar to that required of financial statements, so that ESG-related disclosures are reviewed and approved based on consistent standards.

Taking the Temperature: ESG ratings are a hot topic. As we have recently discussed, U.S. Senate Banking Committee Ranking Member Pat Toomey (R-PA) has requested various information from ESG-ratings providers and the European Securities and Market Authority announced that it is considering increased regulation of the ESG ratings sector. But the conclusions in the Review of Finance Study by and large are consistent with our in-depth discussion of ESG ratings, namely, that the lack of transparency around data considered and weightings accorded various factors and overall

methodology, coupled with the sheer volume of ratings in the market, renders it difficult for investors and other consumers of this information to understand how to use it accurately and effectively. Like the authors of the paper, our "call for greater transparency and precision" in the ESG ratings marketplace reflects these challenges.