



Compare A Range of Available Rating Agencies, ESG Integration Databases and Software

ESG & Sustainability Transformation

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Typical mainstream investment research often includes an ESG or sustainability offering, and most major investment research departments (the “sell-side”) will have analysts producing research in this area.

One way of classifying providers is by business type:

- For-profit large providers that offer multiple ESG-related products and services, as well as non-ESG-related products and services (e.g., MSCI, S&P, Sustainalytics, Fitch, and Moody’s)
- For-profit boutique providers that offer speciality ESG products and services (e.g., RepRisk, Urgentum, Truvalue Labs [prior to its October 2020 acquisition by FactSet], and ISS [prior to its November 2020 acquisition by Deutsche Börse AG])
- Nonprofit providers that offer ESG-related products and services (e.g., Carbon Disclosure Project [CDP], IMF economic data, and World Bank, with the World Bank’s ESG data portal; these services are free to the general public and in the public domain)

Another way of thinking about the services is by type of product or service; this is a non-exhaustive list:

ESG data – quantitative or qualitative information on the environmental, social, economic and corporate governance practices of companies.

ESG ratings – quantitative or qualitative evaluations of a company, country, financial product, or fund, based on a comparative assessment of their approach, disclosure, strategy, or performance on ESG issues. Different methodologies are discussed later.

ESG screening – tools that evaluate companies, countries, and bonds based on their exposure or involvement-specific factors, sectors, products, or services.

Voting and governance advice – typically, proxy vote advisory services. These include voting guidelines on governance and other proxy voting items, including compensation and board directorships.

ESG benchmarks and indexes – a set of securities (e.g., stocks, bonds) designed to represent some aspect of the total market by including some ESG criteria in the selection.

ESG news and controversy alerts – a company or a country conducts assessments that highlight events, behaviors, and practices that might lead to reputational and business risks and opportunities.

Integrated research – typically sell-side (investment bank or broker reports) research of contextualized, data-informed, analytical opinion designed to support investment decision-making.

Advisory services – ESG strategy, integration, investment process, reporting, and corporate advice. Within this are also many specific ESG-related services, such as the following:

- Class action litigation
- Sustainable Development Goals (SDGs) reporting and alignment
- Carbon and water analysis
- Norms and sanctions



- Policy development
- Real estate infrastructure assessment
- Factor databases
- Supply chain assessment
- Assurance services.

The Following Summary provides a non-exhaustive list of ESG ratings and database providers. New entrants are continuing to appear.

Many ESG tools look at a broad range of ESG factors, although some, such as CDP, which has an environmental focus, are more specific. One challenge is that the agreement or correlation between the various ratings agencies is low.

- A study by Chatterji, Levine, and Toffel (2009) finds an approximate 0.3 correlation. (Or more technically, this analysis found pairwise tetrachoric correlations for three years among the six raters, with a mean correlation of 0.30 [about two standard deviations].) However, this also included some negative ones' correlations, meaning that what one rater found responsible another found "irresponsible.") A 2019 study by Gibson, Krueger, and Schmidt shows a range of correlations.
- Yet another study by Berg, Koelbel, and Rigobon (2019) shows a range of correlations as well; Berg et al. look at a dataset of ESG ratings from six different raters: KLD (MSCI Stats), Sustainalytics, Vigeo Eiris (Moody's), RobecoSAM (S&P Global), Asset4 (Refinitiv), and MSCI. The correlations between the ratings are on average 0.54 and range from 0.38 to 0.71.

Berg et al. note, "This means that the information that decision-makers receive from ESG rating agencies is relatively noisy."

Berg et al. further suggest:

Three major consequences follow:

- First, ESG performance is less likely to be reflected in corporate stock and bond prices, as investors face a challenge when trying to identify outperformers and laggards. Investor tastes can influence asset prices, but only when a large enough fraction of the market holds and implements a uniform nonfinancial preference. Therefore, even if a large fraction of investors have a preference for ESG performance, the divergence of the ratings disperses the effect of these preferences on asset prices.
- Second, the divergence hampers the ambition of companies to improve their ESG performance, because they receive mixed signals from rating agencies about which actions are expected and will be valued by the market.
- Third, the divergence of ratings poses a challenge for empirical research, as using one rater versus another may alter a study's results and conclusions. Taken together, the ambiguity around ESG ratings represents a challenge for decision-makers.

Summary of Major ESG Service Providers and Their Products:

- Bloomberg: Data, Ratings, Benchmarks, Controversies.
- Morningstar/Sustainalytics: Data, Ratings, Screening, Controversies.
- Deutsche Börse (ISS): Data, Ratings, Screening, Voting advisory, Benchmarks, Controversies.
- RepRisk: Data, Ratings, Controversies.
- FactSet (TruValue Labs): Data, Ratings, Controversies.
- MSCI: Data, Ratings, Screening, Benchmarks, Controversies.
- LSE (FTSE Russell): Data, Ratings, Benchmarks,
- Reuters (Refinitiv): Data, Ratings, Controversies.



- Moody's (Vigeo Eiris): Data, Ratings, Benchmarks, Controversies.
- CDP: Data, Ratings.
- Real Impact Tracker: Ratings.
- Mercer/Other Investment Consultants: Ratings.
- World Bank: Data.

Source: Benjamin Yeoh (2020); also see Publications Office of the European Union, Study on Sustainability-Related Ratings, Data and Research (2021).

<https://op.europa.eu/en/publication-detail/-/publication/d7d85036-509c-11eb-b59f-01aa75ed71a1/language-en/format-PDF/source-183474104%E2%80%9D>.

Most of the tools are available only commercially. However, the completeness of coverage varies substantially across ESG tools. The correlations might well change with time, as providers evolve the way ratings are produced. For example, Sustainalytics experienced a major change in its ESG ratings system in 2019, and all main providers are currently evolving their processes, annually at least. This is expected for some time to come.

This evolving process also makes historic comparisons difficult. The different methodologies might also mean like-for-like comparisons are not being made in the correlations between rating agencies.

Many factors are still debated by investors:

- What the correlations are
- The timeframe over which they are studied
- The relevance of any potential correlations (could be spurious data-mined)

Practitioners debate how important strong correlations are:

- On one hand, high correlations could lead to groupthink and a lack of rigorous thinking. Some think this was one of the problems with credit rating agencies' (CRAs') (highly correlated) assessment of mortgage-backed bonds in the financial crisis (2007–2009). To some, a low correlation is a healthy and useful outcome from ESG rating providers noting the distinction between ratings and raw data.
- On the other hand, simplicity and correlation could bring credibility to ESG ratings as a discipline and give more consistent messages to companies. As described in the quantitative investment sections, quantitative investors use these data differently than they do fundamental active investor judgments.

The sources of information used to assess ESG investments also vary across the ESG tools. Information can be collected directly (via surveys, company communication, company reports, presentations, and public documents) or indirectly (via news articles, third-party reports, and analysis).

The assessments can be given in raw form or used to determine index weights or processed to determine specific ratings and scores.

The Berg et al. study also argues that low correlations pose these challenges:

- Sustainability performance is less likely to be reflected in company stock and bond prices. Investors are not able to easily identify sustainability outperformers and laggards. Low correlation could have consequences for investors who rely on one single ESG rating in their investment strategies and fail to account for sustainability-related rating disagreement among rating and data providers.

- Divergence restricts companies from being able to improve their ESG performance because they receive mixed signals from ESG rating providers about which actions are expected and will be valued by the market.
- Low correlation poses a challenge for academic and empirical research. Using one rating provider versus another might alter a study's conclusions.

However, some investors argue that variability in methodology and output can be beneficial for investors and a source of insight, as long as there is transparency about how they have been derived.

Another consideration when thinking of providers is where they have come from and which stakeholders are served. Here are some examples:

- "Traditional" ESG data and research providers: founded from the SRI industry to provide investors with sustainability data and ratings about primarily large, publicly traded companies. More recent consolidation activity has turned these providers into conglomerates with different offerings and research focuses. The level of automation is low or medium because human judgment is still used.
- "Nontraditional" ESG data and research providers: More recently, nontraditional providers, such as credit-rating agencies (e.g., Fitch, Moody's, and S&P), entered the space by acquiring Trucost (2016) and Vigeo Eiris (2019), respectively. As with traditional ESG data and research providers, the level of automation is low or medium because human judgment is still used.
- AI or algorithm-driven ESG research: Launched more recently, in the past five years, these providers use new technologies, such as Natural Language Processing, to identify ESG risks and opportunities from web-based sources. The level of automation is high.

Some of these providers might serve corporate issuers and bank and insurance companies as well as asset owners and asset managers. One way to think about these ratings and data providers is through their broad styles and techniques:

- Raw or partially transformed data (e.g., absolute carbon emissions, or carbon Intensity, which is emissions or sales)
- Ratings based on backward-looking reported data
- Ratings or information based on internet, third-party, and web-reported data, aiming to be current
- Aggregators of data or ratings.

The considerations that investors could take into account when choosing providers include:

- The number of companies covered
- The length of history of datasets
- The languages used
- The stability of the methodology
- The regularity of updates
- Asset class coverage
- The quality of methodology
- The range of datasets
- The range of tools and services offered.

Consensus on ESG ratings is currently limited among investors. In that sense, it is similar to current discussions on sell-side equity research, which is investment research typically generated by investment banks. These sell-side ratings (e.g., buy/sell/hold, overweight/underweight versus index, or target prices and credit spreads) are not expected to agree. The rating divergence in opinions can be helpful for investors in decision-making



because it allows both positive and negative arguments to come to light and to be assessed. However, this is somewhat different from CRAs, which typically have highly correlated credit ratings.

One gap is the forward-looking forecasts for ESG data or ratings. Such forecasts are still typically performed by sell-side (at investment banks) and buy-side (at asset management firms) analysts, although not necessarily in a systematic fashion.

Areas of Focus for Investors Compared to Rating Agencies:

Investors often focus on these types of issues over and above what rating agencies do:

- Subsector and company-specific material issues
- A focus on product impacts and actual financial (sales) or extra-financial performance (e.g., customer retention)
- More focus on interpreting raw data
- Drawing deeper insights into associated financial risks for companies.

Investors might focus less on company policies and common disclosures, and might also focus less on history and put a stronger emphasis on forward-looking factors.

To learn more about ESG and sustainability-related models, don't hesitate to contact [**YTT Consulting!**](#)

