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Public Response to FCA CP21/18

From Morningstar Inc. and Sustainalytics, a Morningstar Company

Submitted on 10th September 2021 **by email** to CP21-18@fca.org.uk

Dear Sirs,

Morningstar welcomes the opportunity to comment on the proposed climate-related disclosures and ESG topics in capital markets. We bring several perspectives to this comment letter. First, we have a long track record of categorizing and rating mutual funds that pursue different sustainability strategies. Second, our equity analysts use environmental, social, and governance (ESG) analysis as part of their approach to assessing investments. Third, Sustainalytics, which is now part of the Morningstar family, a leading global provider of ESG ratings, research and data to asset owners, investment managers, financial institutions, issuers/corporates, and a variety of other financial intermediaries. Third, DBRS Morningstar, Morningstar's independent credit rating agency subsidiary, has historically incorporated, and continues to incorporate, ESG considerations into its credit analysis. In early 2021, DBRS Morningstar published the *DBRS Morningstar Criteria: Approach to Environment, Social and Governance Risk Factors in Credit Ratings*, which provides the market with greater clarity and detail with respect to its analysis of ESG risk factors, their definitions and their significance to credit ratings across all sectors. For the avoidance of doubt, unless otherwise indicated, the responses from Morningstar group provided below generally reflect our collective experiences and views, and express references in our response to either Morningstar or to Sustainalytics apply only to those entities.

Morningstar group's response draws from our collective experience in evaluating ESG risks associated with equity issuers and pooled funds as well as the relevant ESG risk factors in the determination of credit ratings on issuers and debt obligations, as appropriate. To provide more background information on the questions you posed, we attach a recent Morningstar research paper to this response letter - Corporate Sustainability Disclosures: An Improving Picture, But Regulation Would Induce a More-Complete and Comparable Baseline of Material Information for Investors.

Fundamentally, as the effects of climate change and governments' responses to it around the world- accelerate, climate and carbon risk has increasingly become material for a host of sectors and many publicly traded companies. Therefore, moves toward mandatory, consistent, actionable disclosures on climate change are vital because they are financially material. As the FCA expands this important work, we would recommend a greater focus on investor needs as the nature and scope of the related disclosures are being considered. Based on our experiences and interactions with investors, we believe that:

1. investors need standard quantitative metrics such as scope 1, 2, and 3 (when material) emissions information from issuers, but these snapshots of carbon emissions are insufficient on their own for investors to evaluate the material financial risks a company faces due to climate change or a shift to a low-carbon economy.

2. investors also need much more consistent disclosures discussing companies' strategies and governance structures to address carbon and climate risks.
3. furthermore, investors need disclosures of companies' respective metrics and targets as well as reporting on progress and performance against these metrics and targets.
4. companies should also provide scenario analysis so that investors can evaluate the extent to which companies' strategies will perform given likely shifts to a low-carbon economy.
5. as we show with data in question 7, TCFD-aligned disclosures are increasingly robust, particularly for certain industries, but there are still gaps in the disclosures available to investors.

Further, Morningstar is broadly in agreement with the FCA description of the ESG data and rating landscape, subject to specific points raised in our answers to the individual questions posed. In particular, one issue touched on is the importance of the clarity and meaningful transparency around ESG ratings and the related methodologies so that investors are armed with the relevant information to understand the meaning and limitations of ESG ratings in the context of their intended use. We would submit that this focus on end-user needs would need to permeate across all relevant market participants – from the issuers providing data that feeds ratings; to product manufacturers' use of them in product design and marketing; to the providers of the ratings themselves.

Given the flow of investments that take into consideration quality ESG ratings, Morningstar group believes it is appropriate to require ESG rating providers to seek some form of certification or accreditation from regulators, adopting a principles-based approach focused on the integrity, independence and quality of ESG ratings. As the FCA text highlights, there are distinct differences between ESG ratings and credit ratings, both in terms of typical business models, and what is being assessed. As per the FCA's accurate description, ESG ratings are multi-dimensional, while credit ratings have a widely accepted common definition. In addition to these differences, we tend to think credit ratings and ESG ratings each are one component or insight to be considered by the relevant market participants alongside multiple other pieces of data and information in making investment decisions.

Diversity of views about the relative weights of the multi-dimensional E, S and G factors exists across users of ESG ratings and should be able to vary across raters, as it does for example across equity research firms more broadly, provided that the methodologies meet transparency requirements.

On behalf of Morningstar group, we again thank you for the opportunity to contribute and will be happy to engage further, answer other questions or provide additional information that may be helpful.

Yours faithfully,

Andy Pettit
Director, Policy Research (EMEA)
Morningstar

SECTION 1 of 3: ISSUER DISCLOSURES

Q1: Do you agree with our proposal to extend the application of our existing TCFD-aligned disclosure requirement (set out in LR 9.8.6R(8)) to issuers of standard listed equity shares, excluding standard listed investment entities and shell companies? If not, what alternative scope would you consider to be appropriate, and why?

Fundamentally, as the effects of climate change and governments' responses to it around the world- accelerate, climate and carbon risk has increasingly become material for a host of sectors and many publicly traded companies. Therefore, moves to expand mandatory, consistent, actionable disclosures on climate change to more companies, as proposed, are essential because such disclosures are financially material, and we believe that investors need

1. standard quantitative metrics such as scope 1, 2, and 3 (when material) emissions information from issuers, but these snapshots of carbon emissions are insufficient on their own for investors to evaluate the material financial risks a company faces due to climate change or a shift to a low-carbon economy.
2. much more consistent disclosures discussing companies' strategies and governance structures to address carbon and climate risks.
3. disclosures of companies' own metrics and targets as well as progress and performance against these metrics and targets.

Further, as shown in our attached report, *Corporate Sustainability Disclosures: An Improving Picture, But Regulation Would Induce a More Complete and Comparable Baseline of Material Information for Investors*, voluntary disclosures have increased over time and mandated disclosures would not be a significant overhead for many companies.

Finally, we are supportive of standard listed investment entities instead being treated under the same rules as for asset managers, for the purposes of consistency of information for investors in pooled investment products.

Q2: Do you consider that issuers of standard listed GDRs and standard listed issuers of shares other than equity shares should also be subject to our TCFD-aligned disclosure requirements? If not, what alternative approach would you consider to be appropriate, and why?

We are supportive, for the same reasons we outlined in our response to Q1.

Q3: We welcome views from market participants on whether to apply TCFD-aligned disclosure rules to issuers of standard listed debt (and debt-like) securities, and how best to do this. In particular, we seek input on the following:

a. What climate-related information from issuers of these securities would market participants find decision useful and how far would these information needs be met by TCFD-aligned disclosures?

Information that reflects sound business strategy and resilience is as useful for debt securities as for equity instruments. In addition, information on climate-related performance covenants or climate/SDG-linked pricing (i.e. spread) differentials would be helpful.

Furthermore, it would be useful to have disclosure of second party opinions or external verifications of debt instruments.

b. Do market participants' information needs differ according to the different types of issuer in LR 17?

Morningstar group believes all financial and non-financial corporations should be expected to provide consistent climate-related disclosures with respect to their equity or debt (or debt-like) issuances.- A more tailored, risk-based approach (to the extent the relevant disclosures are not already provided at the operating entity level by the relevant transaction parties) may be more appropriate for climate-related disclosures in respect of securitisations.

c. If you consider that we should apply TCFD-aligned disclosures rules to issuers of standard listed debt (and debt-like) securities, should some issuer types be excluded from the rule to deliver an effective and proportionate approach? If so, which types of issuers should be included/excluded and how can the scope best be defined?

Please see the previous response to 3b.

d. Are there any other matters we should take into consideration – eg, competitiveness, complexity of the application of the rule, burden on issuers in LR 17, or the feasibility to comply with any potential rules?

As we show in the Morningstar Corporate Sustainability Report, voluntary disclosures have trended upward. Increased levels -standardized disclosures are vital to consistency and transparency - in terms of the information that is available to all investors.

Q4: Do you agree with our proposal to mirror the structure and wording of LR 9.8.6R(8) and LR 9.8.6BG to LR 9.8.6EG for companies with a UK premium listing? If not, what alternative approach would you consider to be appropriate, and why?

Morningstar agrees with the proposed approach. There is much fragmentation across existing and emerging ESG disclosure regulation internationally, and no benefit to increasing that within the UK listed universe.

Setting minimum standards for companies helps ensure comparability across companies and will help investors and asset managers in evaluating their portfolios or describing the carbon risks associated with a pooled investment.

The existing structure and wording allow for proportionality and for a limited comply-or-explain approach.

Q5: Do you agree that, subject to the TCFD's final guidance materials being broadly consistent with those proposed, we should incorporate them into our existing and proposed

handbook guidance provisions as described (including both the existing guidance relating to LR 9.8.6R(8) and our proposed new guidance relating to LR 14.3.27R):

a. the TCFD's proposed updates to the TCFD Final Report and TCFD Annex

b. the TCFD's proposed standalone guidance document on metrics, targets and transition planning

c. the TCFD's technical supplement on measuring portfolio alignment. If not, what alternative approach would you prefer?

Morningstar supports the embracement of the TCFD framework for disclosures because (i) its disclosure requirements align well with the needs of outside sustainability ratings organizations as well as asset managers and other institutional investors; (ii) it is already in widespread use, which will reduce the burden on issuers who need to comply; and (iii) regulators around the world have embraced the TCFD.

Q6: Do you agree that we should update the Technical Note 801.1 to reflect the proposed new rule and associated guidance in this CP?

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Q7: Do you agree with our encouraging listed companies to consider the SASB metrics for their sector when making their disclosures against the TCFD's recommended disclosures, as appropriate? If not, please explain.

A balance is needed between standard quantitative metrics and more company-specific information. The widely debated issues of "double materiality" vs "financial materiality" with respect to ESG sustainability reporting and disclosure also needs addressing. Morningstar supports a building block approach – proceeding initially with disclosure that is focused on "financial materiality" then subsequently expanding, in time-boxed elements, to impact-oriented metrics.

TCFD and SASB offer established frameworks to support such an approach and **l**everaging the TCFD work on best practices for disclosures on strategy, governance, scenario analysis, and metrics and targets is a sensible approach. These disclosures should account for industry-by-industry materiality, while also ensuring that key measures can be compared across companies, industries, and sectors. Such comparability is increasingly critical as investors examine their carbon risk and exposure to climate change at a portfolio level. That said, the TCFD framework is not a corporate reporting standard for metrics

SASB standards offer the kind of industry-specific financially material metrics that most institutional investors require, as they consider financially material carbon and climate risks using data on issuer emissions, emissions trends, and issuer exposure to regulatory changes on emissions; technological innovation that would weaken their position; market trends and peer comparisons for managing carbon risks; and reputational impacts. These analyses rely on quantitative metrics as well as qualitative analysis. Quantitative metrics include the carbon-intensity trends and scope 1, 2, and 3 emissions discussed above, as well as company metrics and targets, while qualitative information include an issuer's greenhouse gas risk management plan, physical climate risk management plan, carbon emissions reduction programs, and renewable energy plans.

Exhibit 1 quantifies the extent to which TCFD-aligned disclosures are already available in many corporate disclosures, particularly in the UK. It shows the average strength of disclosures on five TCFD aligned indicators. The strength of the disclosure is based on the average number of criteria disclosed for each indicator; however, while it reveals the quantity of information, we caution that not all issuers disclose data of the same quality.

Exhibit 1: Climate-Related Disclosure Rates (percentages) in the UK and Internationally

Indicator	UK	Global	Asia/Pacific	Europe	U.S. & Canada	Africa/Middle East	Latin America/ Caribbean
Scope of GHG Reporting	88.9	64.9	46.6	79.6	69.4	57.8	67.6
GHG Risk Management	71.5	63.5	43.2	72.4	75.5	59.6	63.6
Carbon Intensity	86.9	58.6	42.0	74.4	60.1	48.8	62.9
Carbon Intensity Trend	86.5	56.9	40.9	72.3	58.1	48.8	62.9
GHG Reduction Programme	98.8	89.8	83.5	97.1	89.7	86.9	89.5

Source: Sustainalytics Data

Note: These disclosures are based on a Sustainalytics universe of issuers that face material ESG risk[1].

Considering these factors, we agree with the proposed approach, while continuing to monitor the international developments toward more standardisation are escalating, both via the IFRS

[1] Sustainalytics' ESG Risk Ratings measure a company's exposure to industry-specific material ESG risks and how well a company is managing those risks. Further information can be found at https://www.sustainalytics.com/docs/default-source/meis/definitionsofmeis.pdf?sfvrsn=8e7552c0_4

and IOSCO, as well as the closer coordination of various standards bodies. In this regard, we also note the July 2021 cooperation agreement announced by EFRAG and GRI.

Q8: Do you agree with our approach to maintain a 'comply or explain' compliance basis until such time as a common international reporting standard has been published and adopted in the UK? If not, what alternative approach would you prefer, and why?

The time for "comply or explain" is past. As we identify in our attached research paper on Corporate Sustainability Disclosures, we believe it is time to move to the next stage and mandate a baseline set of disclosures. Pragmatically, this may best be done in conjunction with, and relation to, the IFRS international standard-setting developments referenced earlier, and note the FCA expectation of moving to a mandatory requirement in the event those developments are significantly delayed.

That said, "comply or explain" still has a role to play, for example, in areas where raw data is still in its infancy; consistent methodologies are still emerging; or in respect of information that is only material to certain issuers or industries. It has been an important and positive development in ESG disclosure regulations, helping to overcome challenges arising from older regulatory text which allowed for disclosure of ESG factors only if relevant. Those rules made it difficult for regulators to police disclosure and, more important, for investors to be fully aware of an investment product's credentials and understand more about the extent, if any, of a product's internal and external approaches to sustainable investing.

Q9: Do you agree with our approach not to require third-party audit and assurance for issuers' climate-related disclosures at this time? If not, what additional requirements would you consider to be appropriate?

There is already an ecosystem of consultants and traditional accounting firms with the capability to audit and assure these disclosures. Ultimately, if standards are not audited, or if there is weak enforcement of ensuring they are accurate, they will not be useful. Our research indicates that even in cases where we have climate or carbon disclosure, it is often not high-quality. That said, we do not believe that these functions should be restricted solely to accounting firms.

Q10: Do you agree that our new rule should take affect for accounting periods beginning on or after 1 January 2022? If you consider that we should set a different timeframe, please explain why.

The 1 January 2022 commencement date is reasonable given the urgency of the issue, and as referenced above, our research shows a relatively high level of existing voluntary disclosure that indicates it should not be a big burden for many issuers.

Q11: Do you agree with the conclusions and analysis set out in our cost benefit analysis (Annex 2)?

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<u>SECTION 2 of 3 – Green Bonds – SUSTAINALYTICS DRAFTING RESPONSES</u>

Q12: If future changes were considered in relation to the UK prospectus regime, we would welcome views on also taking the opportunity to introduce specific requirements in relation to UoP bond frameworks and their sustainability characteristics?

Morningstar recommends introduction of specific disclosure and reporting requirements applicable to issuers in relation to their UoP bond frameworks that are in line with the existing recommendations in the Green Bond Principles. Such requirements could include, prospectus disclosure on the types of projects/ activities for which an issuer will use the proceeds of an offering, management by that issuer of such proceeds and minimum target impact levels, along with the expected timelines for regular reporting. In addition, each such issuer should also provide the post-offering periodic reporting on the use and management of proceeds of an offering as well as actual impact levels (in reference to originally disclosed minimum target impact levels). Morningstar believes such initial disclosures and periodic reporting by issuers would be beneficial to investors and for the issuers themselves, improving the credibility of such instruments.

We believe a requirement for issuers to include in their UoP bond frameworks a commitment to obtain an initial external review on the framework as well as regular (annual) updates on the use of proceeds thereafter would also be a positive step. The issuers should also be expected to provide disclosure on their related commitments in their related prospectuses. This approach could be instrumental in preventing the so-called 'green washing' scenarios, and enable investors to seek recourse against each issuer upon failure to meet its related commitments.

To be effective, such requirements regarding the elements to be included in the UoP bond frameworks should also be bolstered with strong contractual covenants in the related underlying agreements. In addition to potential statutory remedies to protect the interests of investors that make investments upon reliance of issuer commitments related to use and management of proceeds that are disclosed in prospectuses, consideration could be given to extending contractual remedies for the benefit of investors upon failure by an issuer to meet such commitments.

However, we believe that such requirements should not restrict the issuer flexibility to engage different review providers during the different reporting cycles.

From the review provider's perspective, it is important to note the following:

a. such reviewers (i.e., Sustainalytics) provide opinions based *primarily* on the *information made available by the issuer*
b. ESG data and rating providers are not auditors, and should not be expected to act in an auditor capacity.
c. ESG data and rating providers are not in a position to, and should not be expected to, establish if there are additional undisclosed facts related to a particular bond or use of

related proceeds, beyond the related information the issuer makes available to the review provider.

Based on the foregoing, we believe the liability on the review providers should remain limited to performing best judgement based on the information disclosed. To enhance the credibility and quality of such reviews performed, as noted above, it would be appropriate to require public disclosure by issuers of information on the use of proceeds.

Furthermore, given the fast-paced evolving market, we recommend UoP bond frameworks to be limited to 2 years to ensure reliability of the data provided by issuers to investors and consistency of the frameworks and reviews with the updated versions of the market standards.

Currently, Sustainalytics offers both pre issuance review services, as well as Annual Reviews of allocation and impact reporting to confirm that proceeds has been allocated as promised in the respective framework. The latter are an enhancement of our services, designed to meet market needs, both pre-bond issuance, as well as post-bond issuance, opining on use of proceeds.

Q13: Should the FCA explore supporting the UoP bond market by recognising existing standards (eg, ICMA Principles), potentially through our recognition of industry codes criteria and process?

We are fully supportive of the FCA's following existing standards. In a global market, setting up different standards for different jurisdictions is likely to become disruptive and affect all interested parties: additional costs for compliance/ alignment for issuers; different processes and methodologies for review providers and data that is not comparable for investors, given the different definitions/ interpretations of sustainable activities.

Q14: We would also welcome views on more ambitious measures the FCA could consider, for example to require that the central elements of UoP bonds be reflected in contractual agreements and set out in the prospectus

Please see answer to question 12 above.

Q15: We would welcome views on the potential harm set out above and what, if any, actions the FCA or the Treasury should consider.

We believe that the potential harms identified by the report may have a negative effect over the SPO/reviewer market if not mitigated in a consistent way.

Given some common characteristics of the SPO/reviewer market and the ESG ratings market, and the fact that SPO providers are also acting as ESG rating providers, we are of the opinion that employing consistent regulatory principles for both arms of the industry would be beneficial for all interested parties and mitigate any related regulatory arbitrage risk. However, we submit that ESG ratings, on the one hand, and ESG related opinions (such as SPOs), on the other hand, remain two different and distinct disciplines that should be addressed separately from a regulatory perspective. Morningstar recommends not capturing

ESG related opinions (such as SPOs) in upcoming regulatory framework focused on ESG ratings.

Therefore, as alluded to above, we are of the opinion a regulatory framework on SPO providers should focus on:

a. transparency of the key elements of their methodology, mirroring the similar requirement for ESG rating providers,
b. Standards related to data and information provided by issuers to SPO providers, including practices and processes to assess the sufficiency of the quality of such data and information,
c. quality assurance mechanisms/ programs applicable to the processes to produce SPOs and end deliverable,
d. Sufficiency and training of provider's personnel
e. Set up robust policies on managing potential conflicts of interest, disclosure of such potential conflicts
f. Mechanisms and measure to facilitate reporting of complaints and timely and adequate remediation of such complaints

In our view, such a framework should provide sufficient elements to enable mitigation of the potential harms identified.

Our conflict management framework is built around the requirements described in Commission Delegated Regulation no. 2017/565, and is organized around 6 pillars: I. Internal organization of teams; II. Office facilities and IT infrastructure; III. Data usage, storage and separation; IV. Managing private interests; V. Research process and methodology; VI. Communication with companies

that address the need for analyst independence, consistency of process, data protection and systems separation. An Abstract of the framework described above is available on our website, and further inquiries from third parties about conflicts of interest are managed by our compliance team.

Furthermore, information about our products and high-level information on the relevant methodologies are available on our website.

Q16: Should the FCA, alongside the Treasury, consider the development and creation of a UK bond standard, starting with green bonds?

Yes, provided it is in line with existing EU GBS or other international standards/principles (e.g. ICMA).

SECTION 3 of 3 – REGULATING ESG RATING AND DATA PROVIDERS

Q17: Do you agree with how we have characterised the challenges and potential harms arising from the role played by ESG data and rating providers? If not, please explain what other challenges or harms might arise?

The FCA description of the ESG rating landscape is reasonable in the opinion of Morningstar and this is where we believe the focus should be, as explained in our response to Q20b below.

Paragraphs 4.44 – 4.49 link several different, but related issues, from data gaps, to ratings correlation between providers, to methodologies and scope of ESG matters considered and disclosure thereof.

Regardless of the directionality of impact of more complete and consistent issuer disclosures by issuers on ESG ratings correlation (4.47), having consistent issuer disclosures can strengthen ESG rating firms' analyses and improve the consistency of individual corporate ESG ratings. Different assumptions around data gaps are likely not part of purposeful differentiation by ratings firms, or at least not a key methodology difference.

Diversity of views about the relative weights of the multi-dimensional E, S and G factors exists across users of ESG ratings and should be able to vary across raters, as it does for example across equity research firms more broadly, provided that the methodologies meet transparency requirements.

Investors use ESG research and ratings for different uses, from best-in-class investment analysis to ESG integration to thematic investing to engagement and voting, and while Sustainalytics evaluates ESG issues from a material risk lens, other firms use a broad stakeholder approach, with different views on what is a material ESG issue and on what is measured, outcomes will vary.

Q18: Would further guidance for firms on their use of ESG ratings – and potentially other third-party ESG data – be useful, potentially clarifying expectations on outsourcing arrangements, due diligence, disclosure and the use of ratings in benchmarks and indices? Are there other aspects such guidance should include?

As a provider of ESG ratings and data, Morningstar remains focused on providing meaningful transparency such that our research is user-friendly and responsive to the needs of market participants that consider that research.

As such, ESG rating providers should be expected to make relevant information available to the market. This may comprise disclosure of detailed methodologies to clients (encompassing technical details such as the process for treatment of missing data), while end investors may be best-served by higher-level, consumer friendly overviews of how ESG ratings are compiled and how to interpret them.

Q19: We would welcome views on whether there is a case either to encourage ESG data and rating providers to adopt a voluntary Best Practice Code, or for the FCA to engage with the Treasury to encourage bringing ESG data and rating providers' activities inside the FCA's regulatory perimeter.

Sustainability ratings will continue to play an increasing role in fund flows and be an integral part of investing. As such, it is the view of Morningstar that ESG rating activities should be bought within the regulatory perimeter.

This FCA work is a positive step. A greater degree of commonality in regulatory frameworks across different jurisdictions would lower the risk of potential inconsistencies among regulatory frameworks, increase the comparability of ESG ratings and investor-end user confidence in such ratings and minimize the risks of inadvertently reducing the usefulness and breadth of sustainability-related regulation. This FCA work, together with the recent IOSCO draft recommendations, are positive steps in this regard.

Q20: If there is a case for closer regulatory oversight of ESG data and rating providers, we welcome views on:

a. Whether transparency, governance and management of conflicts of interest are the right aspects of ESG data and rating providers' operations and activities to prioritise in regulatory oversight, and if not, what other aspects should be considered

Transparency, independence and quality of ESG ratings, and management of conflicts of interest are the right areas of focus in our opinion.

In addition to our responses to Q17 (which we do not repeat here), the point that you highlight about the absence of common definitions and terminology is a key one. Ideally the industry should begin to migrate toward a common taxonomy of sustainable strategies (including those that address climate change) so that investors can understand what to expect (and what they should not expect). In the financial product arena, Morningstar has developed a sustainable investing framework that can help investors understand what overall role sustainable investing plays in a strategy (no role, supporting role, leading role) and the specific types of approaches that may be employed: (i) the use of exclusions, (ii) the use of corporate ESG evaluations to better assess risk, (iii) the use of corporate ESG evaluations to identify investment opportunities, (iv) orienting active ownership activities around ESG considerations, (v) a focus on sustainability themes, (vi) and the incorporation of impact assessments.

Potential conflicts of interest are an important issue and at a minimum, ESG rating providers should publicly disclose the sources of potential conflicts of interest in their business model as well as the steps they take to mitigate these conflicts of interest. Beyond these public disclosures, ESG rating providers should disclose any potential conflicts of interest to specific clients if those conflicts could be relevant. We believe this could be beneficial to all players involved and promote plurality and innovation in this market.

Associated governance processes to manage the above aspects are vital and having a culture of compliance and written processes is a necessary requirement for ensuring quality, although public disclosure of such processes would seem excessive. We provide further specific comments in our responses to subsequent IOSCO recommendations below.

Companies should have a right to respond to ESG rating providers, while preserving the independence of the ESG ratings and opinions. Morningstar already submit our ratings and research for pre-publication feedback to around 4,500 companies because we agree with the importance of providing them with a chance to inform us of any factual errors in our assessments.

b. Whether and how regulatory priorities should differ between ESG rating providers and other ESG data providers

Morningstar believes regulation should focus solely on “ESG ratings”, with there being no policy argument to single out and regulate “ESG data providers” (entities that aggregate, create and/or distribute ESG data) since data aggregation/ distribution is not otherwise regulated in any other sphere of financial services industry. To the extent an ESG rating provider also offers ESG data services, and such data (aggregation/distribution) services may represent potential conflicts in the context of provision of ESG ratings, such conflicts can be identified, managed and mitigated as part of the governance of all potential conflicts that are relevant for ESG rating business. Presence of any such potential conflicts does not necessitate regulation of ESG data.

c. The similarities and differences between the policy issues that arise for ESG rating providers and those that arise for CRAs, and how far these similarities and differences might inform the appropriate policy response

There are distinct differences between ESG ratings and credit ratings, whereby the latter have a widely accepted common definition and the former are multi-dimensional and still evolving. Such differences, in part informed by the feedback provided by Morningstar’s independent credit rating subsidiary, DBRS Morningstar, are referenced elsewhere in our response, as appropriate. Morningstar group would welcome an opportunity to engage further with the FCA to review the related considerations in more detail.

Despite these differences, transparency is key in ensuring that users of ratings understand the purpose and methodology of each rating and are equipped to understand the rationale for different issuers receiving different ratings from different providers. Similarly, given the evolving nature of ESG analysis, transparency is also vital in ensuring that users of ESG ratings are aware of and understand when and how methodologies, and thus potentially individual ratings, change.

Further, the issue raised about ‘ratings shopping’, or factors that might influence which rating providers an issuer works with goes to the heart of why mandatory issuer disclosure is needed. Consistent issuer disclosures will likely result in more informed ESG ratings and reduce the impact of issuers prioritizing information provision to some ESG rating providers ahead of others.

Q21: What other ESG topics do you consider that we should be prioritising to support our strategic objective? Please explain.

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