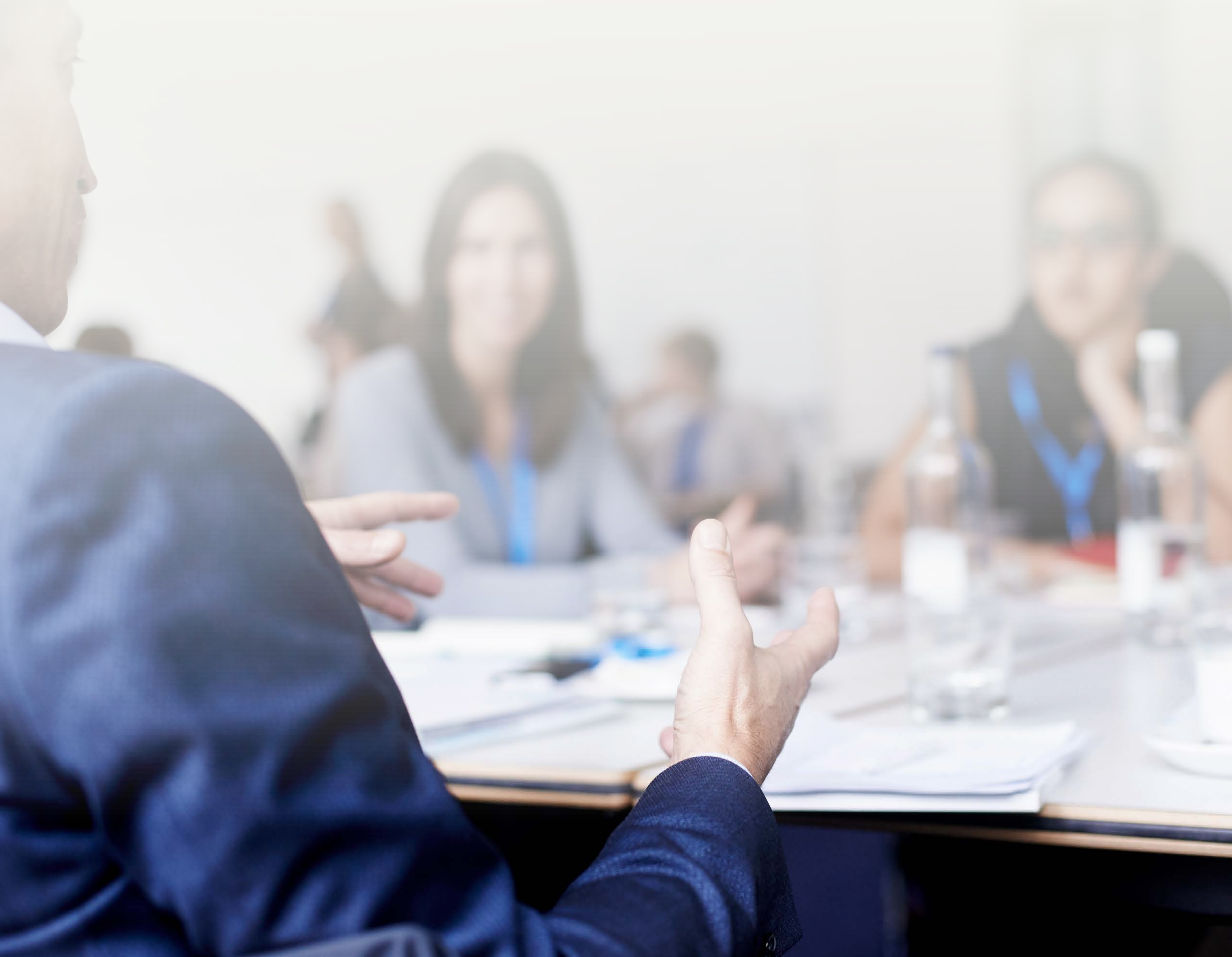
Rate the Raters 2018:
Ratings Revisited

March 2018



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Introduction

In May of 2010, SustainAbility launched a multi-phase research program, Rate the Raters (RtR). RtR was designed to influence and improve the quality and transparency of corporate sustainability ratings. It proved enormously popular. Many companies and financial industry stakeholders tell us they still regularly reference this seminal work. Now we propose to re-engage on this topic.

Our original research looked at 50+ ratings and rankings within a total ratings universe of 100+. Today, the Global Initiative for Sustainability Ratings identifies over 600 ESG ratings products globally, making it increasingly difficult for companies and investors to navigate this landscape.

To explore the current ratings landscape and to better understand the need for new RtR research, SustainAbility hosted three roundtables with corporate sustainability professionals, investors, analysts and ratings representatives in the first half of 2017. The roundtables were hosted in London, New York and San Francisco. We also undertook many bi-lateral discussions with ratings stakeholders.

We tapped a nerve. Five years after the last RtR publication, we found that corporates still struggle with how to decide which ratings and rankings to prioritize. Corporate stakeholders are still using RtR to guide internal decision making on ratings and expressed interest in an RtR update that would more fully incorporate investor points of view on ratings. Investors point to increasing demand for ESG integration and ESG-focused portfolios; they want to know which ratings and data providers companies value and respect. And, raters attending the roundtables noted the struggles companies face with the growing number of ratings while holding firm in the belief that each and all the ratings they back provide value.

This paper outlines the themes emerging from the 2017 RtR outreach (roundtables, interviews and other bi-lateral conversations) and explores why and how the themes merit new research. It provides an immediate perspective on the state of play in the ratings arena, and the response to this paper will help us determine whether funder and partner interest is sufficient to support a comprehensive RtR update in 2018.

If the ratings challenge in 2010 was maturity and quality, SustainAbility believes the complexity of the ratings field, ratings' business models, and the way they are published, distributed and applied are the most pressing issues today. We believe there are significant opportunities to improve corporate disclosure, ratings and rankings and investor ESG integration moving forward and aim to explore these with our 2018 research.

Terminology

For the purposes of this paper we define ***ratings*** as evaluations of a company based on a comparative assessment of their quality, standard or performance on environmental, social or governance issues. These pertain to individual companies. Examples include MSCI ESG Ratings, Sustainalytics ESG ratings and CDP company performance scores.

Rankings are lists that classify companies based on their performance and put them in a certain order or grouping based on a specified grading system. Examples include the Dow Jones Sustainability Index (DJSI) and the FTSE4Good Index series.

We specifically exclude sustainability or ESG ***guidelines***, like the Global Reporting Initiative (GRI) standards or Sustainability Accounting Standards Board (SASB), and ***agendas***, like the Sustainable Development Goals (SDGs), from this list, except as ratings reference points, since they are not designed to rate or rank, but rather establish a framework for reporting and evaluation.

Emerging Themes

The emerging research themes in this section are derived from roundtable discussion and interview insights as well as from SustainAbility client feedback and team engagement. Roundtables and RtR exploratory interviews have included corporate sustainability professionals (the largest group), investors, analysts and the ratings representatives listed in Appendix B. As roundtables and interviews were conducted under the Chatham House Rule, quotes in this report are unattributed.

- **Theme 1:** Crowded, Complex, Costly, Time Consuming
- **Theme 2:** Value Versus Time
- **Theme 3:** The Merits
- **Theme 4:** Quality is an Issue

> **What business value do we get from doing ratings? How can I answer that confidently?**
>
> Corporate Stakeholder

Theme 1: Crowded, Complex, Costly, Time Consuming

Too Many Ratings and Too Little Differentiation

Corporate participants say they are receiving more requests for information than ever from an expanding number of ratings organizations. Just deciding which to engage is challenging and time consuming. Companies also report significant ratings overlap and duplication. While this trend demonstrates increasing focus on corporate sustainability and ESG performance, corporates can be left frustrated and even confused.

> *"It seems like the wild, wild west, with each ratings organization coming up with its own methodology – methodologies which are only sometimes shared. On the flip side, it's really positive, suggesting greater interest and attention."* – Corporate Stakeholder, Banking Sector

Companies Struggle to Keep Up

Not just the number but also the complexity of both new and existing ratings has increased. DJSI, CDP and others have expanded to cover more issues, increasing the number of surveys and the number of survey elements and questions. While more data may improve analysis, the growing requests put additional demands on companies. Many surveys are issued at the same time of year; taken together, they can represent thousands of hours of response time, often overwhelming corporate sustainability, IR and communications teams.

> *"Reporting fatigue is still real. They all come at the same time and often require quick turnarounds, meaning we frequently just have to say no to those ones that don't give them enough time. That's a missed opportunity for the rater."* – Corporate Stakeholder, Energy Sector

> *"One of the reasons we prioritize is that responding to each rating takes so much time. Responding is made even harder and more time consuming when the information requested changes, which it does regularly. We hesitate to participate in new indices because completing questionnaires is hardest the first year."* – Corporate Stakeholder, Apparel Sector

Too Costly

Another polarizing issue for companies are the costs associated with ratings, with some ratings charging companies fees before accepting their responses. This can gall when companies later see their responses repackaged and sold, and may represent a conflict of interest. Companies appreciate ratings have commercial business model challenges, but the fees are unpopular and keep some companies from participating in some ratings.

> *"I spent a day responding to a new supply chain survey recently, then was asked to pay to post the information I was providing on the rater's website. This left me outraged – if anything, raters should pay us for this data – but this practice is becoming more common."* – Corporate Stakeholder, Banking Sector

> *"Ratings charging fees is not just bothersome, there is a potential conflict here. Ratings get paid for their analysis. Is the analysis complete and objective if companies have to pay fees in order to participate?"* – Corporate Stakeholder, Banking Sector

Theme 2: Value Versus Time

Corporates Rank Raters

With more ratings than any company can respond to, corporates are forced to prioritize some ratings and ignore others. Sustainability professionals seek ratings that will drive change in their organizations and provide better data on competitors. Companies want help understanding which ratings their peers do and don't respond to.

> *"Our company's approach to ratings is strict. With each rating, we consider whether it will make a material difference. We make this assessment annually and decide to discontinue some ratings nearly every year."* – Corporate Stakeholder, Technology Sector

> *"I need more information on what my peers and competitors are doing, which ratings they value and why."* – Corporate Stakeholder, Food/Beverage Sector

Saying No

The current environment is so frustrating that many companies are choosing to stop responding to certain ratings. Others report on schedules of their own making, shifting priorities as necessary to circumstances. One company quit CDP Water during the California drought to free up the time to create a drought task force focused on action. While some companies strategically choose to say no, companies note the danger in not responding to a rating or in being inconsistent – they may miss the chance to get the right information to raters and investors.

> *"Our only power is to put down the pen, but there is risk in that too, as they rate you whether you respond or not. I'd rather have a rating out there with our input than not."* – Corporate Stakeholder, Banking Sector

> *"Some companies are protesting and choosing not to respond. I am hearing anecdotally that the value of participating in DJSI is under question among my peers."* – Corporate Stakeholder, Pharmaceuticals Sector

Finding the Balance

Ratings create of months of work inside companies – filling out surveys, verifying information and fielding calls with investors and ratings agencies, checking outputs and analysis, etc. This can leave companies questioning the point at which ratings response takes too much time away from driving business performance.

> *"The balance between reporting and impact is so important. Are you spending adequate time doing rather than reporting? Too much reporting / ratings participation can keep companies from investing time in change."* – Corporate Stakeholder, Energy Sector

> *"While certain indices get a lot of attention, and stakeholders take notice, ratings participation does not actually make us a more sustainable company."* – Corporate Stakeholder, Food/ Beverage Sector

Theme 3: The Merits

Ratings Engage, Inform and Change Companies

Education and Internal Engagement: Answering ratings questions on topics ranging from packaging and waste to employee diversity, human rights and supply chain conditions raises awareness of shifting investor and societal expectations for corporate sustainability performance. Crafting responses to ratings questionnaires is cross disciplinary in most companies, forcing functions to engage and build relationships across the organization. These relationships are critical to wider sustainability progress, mainstreaming sustainability and driving change.

> *"Working on ratings helps build understanding of the different connections and overlap essential to sustainability across the business."* – Corporate Stakeholder, Banking Sector

> *"Responding to surveys forces communication across different parts of the business and spurs conversations around what can we do better and how to drive change in the company."* – Corporate Stakeholder, Insurance Sector

A Catalyst: Ratings sometimes drive immediate change. Poor rankings or scores often attract management and leadership's attention, especially if the rating is one the company and key executives respect and have agreed to target. This underscores the importance of executive engagement on and understanding of specific ratings credibility and their relevance to ensure companies participate in ratings with the right focus.

“*We have a love-hate relationship with ratings. For example, human rights is huge for us, and two years ago we were about to lose a point on DJSI based on our response on transgender rights. This was not acceptable to us as a company so we took action. Within a week we had a new policy on the issue and we did not lose the point, which was important to us – so important that we take actions like this on specific topics. This is somewhat DJSI unique – our C-suite knows Dow Jones – but other ratings have similar potential.*” – Corporate Stakeholder, Technology Sector

“*MSCI became top priority because we had a low score on labour, and an investor asked the CFO why. That spurred the company to work much harder at this index. However, if the CEO or CFO knows about it then it's a priority, but if not then it's not.*” – Corporate Stakeholder, Packaging and Paper Sector

Maintain Credibility: Performing well in the right ratings can establish credibility with some investors and improve access to others. Consistent performance on certain ratings and indices demonstrates a commitment to sustainability over time and helps maintain a positive corporate reputation.

“*This is about reputation. We use ratings to establish credibility with investors and win green finance business opportunities. We talk about DJSI and FTSE4Good performance emphasizing how long we have been ranked there as evidence of our track record. Sustainalytics is another we use to express / prove our sustainability credentials.*” – Corporate Stakeholder, Banking Sector

Foresight and Insight: Companies use ratings to identify emerging issues and to benchmark performance against peers. Ratings evolution informs corporate leaders on shifting societal expectations.

“*The business value of participating in credible ratings is benchmarking how you're doing relative to peers. Ratings also reveal emerging issues. We view new questions/topics they've added as early warning signs about issues that are starting to emerge. When we see the same issue pop up across a few ratings, we know it's time to really look into that issue and what we're doing about it.*” – Corporate Stakeholder, Energy Sector

Ratings Engage and Push Investors – But Not Enough

ESG Basics: Ratings are often the starting point for investors in terms of incorporating ESG into equity analysis. For investors new to ESG evaluation, ratings educate and explain some of the nuance around these issues. ESG ratings can also play a meaningful part in investment decisions, but do not drive final investment decisions on their own.

> *"Part of our job as raters is education. Particularly in the US, investors use ratings as a starting point for understanding ESG risks and opportunities. When working with investors we educate them about the data and help identify opportunities."* – Rater Stakeholder

> *"Ratings are the first step to understanding companies and what they do, but one cannot base investment decisions solely on the results of survey responses and the profiles produced by ratings agencies."* – Investor Stakeholder

Multiple Ratings Provide Context: Investors using ESG data need context, which the use of multiple ratings can provide. The breadth of ratings can help paint a more complete picture of companies being considered for investment, making investor decision-making more informed.

> *"From an active investment perspective, it's not a huge issue if a company is a laggard on one of these ratings – that's not going to sway an investment decision. But each rating adds useful context. The more comprehensive the rating the better e.g. we find CDP useful because their reports include numbers, methodology, background information and more which we can then take and apply in our investment decision-making. Where ratings just provide letter grades or scores without data it is not useful – we have to be able to verify the methodology."* – Investor Stakeholder

Investors Themselves Remain Opaque: It remains difficult to tell which investors actively apply ratings or other ESG information through bottom up investment analysis. Anecdotally we know many investors are educating themselves on the nuance, complexity and sectoral differences of ESG analysis, but there is little evidence of how widespread such effort is. More information on investor views of ratings, which they value and why, and what more and different information they need, is required.

> *"We often just can't tell: Do investors think ratings are material? How do ratings and rankings get digested to make better investment decisions?"* – Academic Stakeholder

> *"Some investors do due diligence on ratings and contact company investor relations departments to ask about scores, but I don't know that many investors who are doing that."*
> – Corporate Stakeholder, Banking Sector

ESG Engagement Slow but Growing: Companies note that more ESG questions are popping up on investor or analyst calls but claim this is still quite rare. The feedback loop between companies and investors needs improvement so companies can hear straight from investors whether and how their participation in ratings is valued by investors.

> *"When I was a CFO, I never had a single analyst ask a sustainability question, and that's been true of my recent discussions with analysts also. But there are signs like the Exxon vote [a 62% vote by shareholders in favor of a climate change disclosure resolution in June, 2017] that times are changing."* – Academic Stakeholder

> *"Our CFO actually got asked an ESG question recently on an analyst call, which put that ESG issue on the CFO's radar."* – Corporate Stakeholder, Insurance Sector

> *"Even when we have been reporting to a particular rating for years, we get little or no feedback from clients on the value of doing this."* – Corporate Stakeholder, Banking Sector

Theme 4: Quality is an Issue

Risk of Oversimplification

Sustainability and ESG issues are nuanced and complex. They require context to fully express performance implications. Reducing analysis of an issue to a single number or grade, let alone a single number across multiple issues, is difficult and perhaps even misleading. Ratings that don't offer context risk not showing the full picture.

> *"Quantitative data has greatly improved, but a lot of data rightfully needs to be qualitative. Do ratings and investors take time to read qualitative responses to questions and then factor that into perspectives on performance? A lot of this work is nuanced; context is critical, and results can't be boiled down to one number."* – Academic Stakeholder

Immaterial

Companies too often find they are rated on issues they do not believe are material to their business and to their sustainability performance. While ratings are right to push new issues at companies, this gap in agreement on what is material is too wide, and it frustrates companies when issues they do not accept as material impact overall rating scores. Companies also note ratings struggle to benchmark unique or evolving business models, saying they are sometimes punished for being different and trying something new compared to corporate peers, and they add that ratings don't have good methods to assess holding companies.

> *"Raters need to find out exactly what the business does; investors won't buy research unless raters demonstrate they fully understand the companies. Too few do and quality varies a lot."* – Investor Stakeholder

> *"DJSI is challenging because it covers everything and we sometimes get dinged for things that aren't material. Ratings that go in depth on the most material issues for a company are the most valuable."* – Corporate Stakeholder, Energy Sector

> *"Even within an industry it's comparing apples to oranges. Ratings aren't in a position to give the guidance they claim they can."* – Corporate Stakeholder, Pharmaceuticals Sector

Opaque

When companies and ratings users can't unpick how a rating works, they don't trust that it focuses adequately on material issues or that it truthfully evaluates corporate actions. Simply put, ratings that fail to be transparent about their methodologies lose credibility, and too many ratings are not transparent enough.

> *"Ratings need to be fully transparent about methodology. Sometimes companies are rated regardless of whether they respond or not, and it is not always obvious whether this will be the case when a ratings request appears. This annoys companies willing to do the work to determine whether they should participate."* – Corporate Stakeholder, Pharmaceuticals Sector

> *"Looking at transparency of indexes themselves – is it really CR (Corporate Responsibility) or just PR? What does it mean that you get an A on CDP, for example? Maybe that company outsourced completion of the questionnaire instead of having an internal CR team do it – so they might get an A, but if they were examined more closely, they'd get an F on something specific. Versus another who gets a C but they have an internal sustainability team filling out the questionnaire and more resources allocated to CR in general."*
> – Corporate Stakeholder, Energy Sector

Disengaged

Companies note instances where scores or ratings were not changed or updated even after they changed ESG procedures or performance and feel ratings are not responsive enough to their efforts. On the other hand, companies know how to game the system and get points in certain areas, often hiring third parties to help them improve scores. If ratings engaged more with companies, performance improvement would be better recognized and gaming would be more obvious. The best raters engage deeply enough to differentiate performance from story-telling.

> *"There have been some points in the past where a rater will rate us as high risk and then, even after we address something or change things, they don't change their ratings. That hurts credibility. Are these companies trying to be shamers or are they actually trying to evaluate real risk?"* – Corporate Stakeholder, Energy Sector

> *"The issue I have with ratings is they have zero context. Companies are very good with smoke and mirrors and saying things that ratings want to hear. I can't get context by looking at a number. Ratings are useful for investors to see where to start, but you have to engage companies to figure out what is going on."* – Corporate Stakeholder, Pharmaceuticals Sector

> *"You can easily improve your scores without actually doing anything of value – for example, on one rating my score can go up by 10 points for employee training if I send a link to people, but am I really changing something in the business?"* – Corporate Stakeholder, Energy Sector

Raw Recruits

Companies and investors have noted concerns that ratings analysts lack the expertise and/or experience required to ensure quality and consistency in results. Some investors complain that ESG ratings and rankings are not yet investment grade. Companies want to see seasoned analysts evaluating them and to have a discussion with an analyst that truly understands their sector when they have a question on a rating. Both investors and companies seek more transparency around the backgrounds and experience of ratings analysis teams.

> *"Raters need to have true industry experts on board and need to understand industries deeply. I want more raters I can trust."* – Corporate Stakeholder, Energy Sector

"There is a lot of churn and burn on the due diligence process. Ratings analysts might only get a couple days or a week to do due diligence and determine something like climate risk and that's really tricky." – Sustainability Consultant

"When we get rated on information in the public domain, I find it's not always necessarily true what the raters glean. In those instances, it seems they haven't read our information properly, they may be cherry-picking or not referencing the most recent information. I get frustrated with the quality of the work that gets sent to me particularly since it's so time consuming for me on the front end. This results in me feeling like the people rating me have no understanding of our business." – Corporate Stakeholder, Agriculture Sector

Rate the Raters 2018:
Ratings Revisited

The ratings field has clearly evolved since the original RtR series was completed. Today's ratings landscape shows evidence of progress as well as continued weakness. The present ratings arena is more important to driving change and at the same time more complicated and contentious. Above all, ratings still have a critical role to play. With all this in mind, RtR 2018 will explore how the field has evolved and where it yet must go.

Project Objectives

The next RtR cycle will test ratings efficacy using a transparent methodology informed by company, investor, rater and other stakeholder input. It will make recommendations as to how ratings producers and users can contribute to better analysis, outputs and application. It will improve rater-company-investor communications and relationships. To this end, we plan to conclude with a summit or series of rater-company-investor dialogues designed to explore Rate the Raters' conclusions and unearth the best ways to address and apply the findings.

Throughout the Rate the Raters 2018 research we will seek to:

Uncover key shifts in the ratings landscape:
What have been the biggest changes in the ratings industry in the five years (since 2012 when the original Rate the Raters series was completed)? How has the growth and consolidation in the ratings industry impacted quality? How has the rapid expansion of passive investing affected ratings and their efficacy?

Understand which ratings investors and sustainability experts are using and why:
Which ratings are most credible in the eyes of companies and investors and what makes them credible? Why do companies and investors sometimes value ratings differently?

Guide best practice and identify opportunities to improve:
How are ratings presently communicated and applied and what are the results? How and why do companies and investors want ratings to evolve? What can ratings do to assure relevance and greater impact on corporate sustainability performance and investment practices in the next five to ten years?

Timing & Logistics

To answer these questions, SustainAbility is embarking on a four-part process:

1

Fundraising (Winter 2017/18)

Following the release of the *RtR 2018: Ratings Revisited* report on our 2017 ratings field exploration, we will be raising money from companies, investors and other stakeholders to fund the research and project costs.

2

Sustainability Expert and Investor Surveys (Spring 2018)

After adequate funding is secured, we will develop and field surveys with sustainability professionals and investors, conduct interviews, and gather and interpret the results. This research will ultimately inform an updated view of which ratings sustainability professionals and investors find most credible and why.

3

In-Depth Research (Summer 2018)

Based on the survey and interview results, we will analyze selected ratings and rankings to evaluate their performance on issues including: transparency, methodology, corporate engagement and analyst experience/expertise.

4

Report Launch & Stakeholder Convening (Fall 2018)

We will convene investors, companies and raters to share and discuss the report results and identify opportunities for improvement and how all stakeholders can work together to improve.

Get Involved

There are many ways you can get involved from funding to feedback and participation in our interview process. Your involvement will directly support leading thinking and research on the ratings agenda.

1) Sponsorship

We invite you and your organization to support us. All sponsors will receive early access to insights, co-branding, the opportunity to participate in launch events and an invitation to closing convenings.

Research Partner	Research Sponsor	Principal Sponsor
$10,000 (or equivalent)	$25,000 (or equivalent)	$50,000 (or equivalent)
Research Partners will receive the following benefits: • Participation in the research process, including regular updates and discussion of preliminary findings • Brand association with project outputs including logo inclusion in the research in print and online • Social media engagement via Twitter and LinkedIn	**All Research Partner benefits, plus:** • Exposure and potential speaking roles at launch events and Rate the Raters, 2018 convenings • Engagement with media partners • A customized briefing applying our findings to your company	**All Research Sponsor benefits, plus:** • Logo inclusion on the cover of the research outputs in print and online, as well as within all related press releases, articles, blogs, presentations and webinars • Opportunity to host a launch event and/or convening (final event locations to be discussed and agreed with Principal sponsors) *There will be a maximum of two principal sponsors*

2) Your feedback and participation

What has your experience been with ratings and rankings and how do you hope they evolve moving forward?

We are looking for perspectives from experienced professionals across corporate sustainability, investment and ratings agencies. If you are interested in participating in our surveys or interview process please let us know. We welcome and value your interest and feedback on this paper and the project overall.

For more information on how to get involved in this exciting project, please contact project lead Christina Wong:

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Appendix A

Previous Rate the Rater Research

For more information on our previous research on this topic, see below.
You can also access all of our past reports on our website at SustainAbility.com

Phase One explored the evolution of the ratings agenda, identifying key trends and challenges such as the difficulty in rating companies across sectors, the lack of focus on the economic leg of the triple bottom line and whether ratings are helping to drive us to a sustainable future.

Phase Two was based on an inventory of over 100 ratings and their attributes and included the results of our survey of sustainability experts' perceptions of ratings.

Phase Three included an in-depth evaluation of 21 ratings designed to shed light on the various methodologies and approaches employed.

Phase Four outlined our vision for ratings in the future, which called for competition on analysis rather than data collection, greater focus on material issues and impacts, and improved transparency.

Phase Five discussed how ratings are being used by sustainability professionals and investors.

Appendix B

Rate the Raters Roundtable Attendees

Sector

Academic (4)
Agriculture (1)
Apparel (2)
Asset Manager (1)
Automotive (3)
Banking (8)
Carpeting (1)
Consulting (6)
Consumer Products (1)
Energy (7)
Entertainment (1)
Food/Beverage (3)
Industry Organization (5)
Insurance (1)
Investor (5)
Mining (2)
Paper (2)
Pharmaceuticals (2)
Rater (4)
Tech (4)
Travel (1)

Geography