February 2023

ESG Ratings Providers, Reporting Frameworks, and Reporting Platforms: What are the Differences and What Do Agencies Need to Know?[1]

1 Note that this document is intended for a U.S.-based audience.

Contents

INTRODUCTION

For a concept represented by such a simple acronym, the Environmental Social Governance (ESG) landscape can get very confusing, very quickly.

The very term ESG appears to have first appeared in a report called the "Freshfields Report," authored at the request of the United Nations Environment Programme Initiative in 2005. The Freshfields Report[1] (Freshfields is an international law firm) was a deep dive into seven specific countries[2], and how their respective laws and regulations around investment fiduciary responsibilities would treat the introduction of having to weigh ESG variables into investment decisions.

And while the term ESG has its origins in the financial sphere, the evolution of the acronym 17 years later has come to encompass a multitude of different outlets. The confusion in the reporting and frameworks space alone is understandable, particularly given that EY recently estimated there to be over 600 ESG frameworks and standards around the world. Some of them are specific to certain countries, others to certain industries, etc.[3]

And while a full accounting of the entire current ESG global landscape would likely require the acquisition of extra server space, the good news is that much of that information is well beyond the scope of what most agencies need to know to get a handle on some of the important distinctions in this space. And, while this area is fast-evolving, a helpful starting place for many agencies will be to understand the distinctions amongst ESG ratings providers, ESG reporting frameworks, and ESG reporting platforms.[4]

Agencies are being asked more often by clients to adhere to some of these ESG frameworks or reporting platforms (or both), a topic which will be covered below. Given the recent proliferation of ESG reporting platforms and options, it's increasingly important that agencies understand the choices in front of them, and that they particularly understand developing client preferences in this area.

1 ESG Ratings Providers

ESG ratings providers are private investment ratings companies that rate a company's ESG performance against a set of unique metrics specific to that ratings provider (i.e. these ratings providers are not using a common set of metrics, which is why there is such divergence in ESG ratings from provider to provider). ESG ratings providers in this space include companies like Refinitiv, Bloomberg, MSCI, S&P Global, Sustainanalytics and Moody's.

---

1 https://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf

2 France, Germany, Italy, Spain, U.K., Japan and the U.S.

3 https://www.ey.com/en_gl/public-policy/what-to-watch-as-global-esg-reporting-standards-take-shape

4 Note that there is significant overlap in nomenclature in the ESG space, i.e. not all of these terms are used in the same way by various entities, some terms are used interchangeably, etc. The terms "reporting standards" and "reporting frameworks" and "governance frameworks" seem to be used somewhat equally to often mean the same thing. Even the term "ratings provider" is by no means uniform. The newness of the ESG space seems to have led to very fragmented nomenclature in many areas, resulting in a fair amount of confusion.

The various metrics being used by ESG ratings providers has been a source of controversy lately, for a variety of reasons. Some critics have pointed out that ratings vary too much in what they measure and how they measure it (i.e. some might measure companies' lobbying practices, some might not; some might give more weight to diversity hiring practices than others; some prefer one type of reporting framework, others prefer a different one, etc.).This lack of standardization unfortunately likely renders some of these ratings confusing at best, and misleading at worst.

Additionally, these ratings providers are assessing companies on a global scale. If your company doesn't operate outside the U.S., then the stricter guidelines and actions (voluntary and mandatory) in other regions like the EU might make it more challenging for ratings providers to compare and align.

It's worth taking a step back for a moment to remember why all of this matters more and more to the investment space. ESG ratings are increasingly important to investors who control an outsized share of the market. While the big institutional investors like BlackRock, Vanguard Group, State Street Global, Fidelity, etc. still hold the top five spots in terms of assets in billions[5], it's also worth remembering that many large institutional investors are pension fund groups and academic institutions endowment funds, like Yale's endowment fund, which is estimated to be over forty billion dollars.[6]

Many academic institutions endowment funds, including Yale's, have moved in recent years to divest their investing of any fossil fuel companies under pressure from students wanting to see a greater commitment by the institution to sustainability initiatives. ESG ratings can play a large role in how these entities consider their investments, even though there continue to be questions as to what exactly is being measured by these ratings, including ongoing concerns about greenwashing in the ratings themselves.[7]

It's likely that this area will see more regulation in the future, although it's unclear what form that will take. The Securities and Exchange Commission (SEC) has recently been engaged in a new rulemaking process that would require companies to report specific data about climate-related disclosures and greenhouse gas emissions in their public filings.[8] It is likely this rule will go into effect in some form in 2023. Should this new rulemaking become finalized and survive a likely judicial review, it would become a standardized data point for ESG ratings providers to utilize, although it appears what the SEC would require is already being provided by many publicly-traded companies in other formats to investors, board of directors, etc.

And while the SEC is currently involved in a rulemaking that would mandate and standardize certain climate risks disclosures, it doesn't appear at present that the SEC is considering a separate action to bring clarity and more uniformity to the ESG ratings market. But the SEC does

5 https://www.pionline.com/largest-money-managers/2022

6 https://yaledailynews.com/blog/2022/10/24/yales-endowment-explained/

7 https://www.bloomberg.com/news/newsletters/2021-10-02/esg-whistleblower-calls-out-wall-street-greenwashing-new-economy-saturday

8 https://www.sec.gov/news/press-release/2022-46

appear to be aware of the issue. A recent Harvard Law Review article pointed out that while credit ratings agencies had a 99% correlation amongst credit ratings for the top credit rating agencies, ESG ratings are approximately 60% correlated across top ESG ratings providers, a troubling divergence.[9]

AGENCY CALLOUTS

- Given that these ESG ratings are currently mostly being applied to publicly-traded companies, if an agency is not a publicly-traded company, the issue is not a direct concern.
- However, given the evolving landscape of how some publicly-traded companies are increasingly looking to include Scope Three emissions in their own reported carbon footprints (something that ESG ratings providers do look at), then it's likely in the future that clients that are publicly-traded companies will want to see substantiated carbon footprint metrics from their partners, which could include agencies, although it's not clear that's happening to date.

2 ESG Reporting Frameworks

Given the earlier data point from EY that there are over 600 ESG frameworks and standards around the world, it's easy to understand why agencies might be confused as to what's out there, and more importantly, what they should be paying attention to in the years ahead.

Before further discussion of specific ESG reporting frameworks, it's worth taking a step back to understand why and how some of these frameworks are used. To date, many of these frameworks have been more the province of publicly-traded companies, as these frameworks (particularly Sustainability Accounting Standards Board or SASB and Task Force On Climate-Related Financial Disclosures or TCFD, mentioned below) contain information that ESG ratings providers and other investors want to see.[10] SASB and TCFD lean heavily on reporting pertaining to issues around financial materiality, etc. For that reason, these frameworks have been more embraced by public companies who have a greater need for this level of detail for investors.

While some of the differences between SASB and TCFD can be described as a matter of opinion, there seems to be a somewhat general consensus that SASB is a bit more reflective (i.e. a bit more backward looking), while TCFD is a bit more forward looking. For many companies, specific investors might prefer one over the other, and a company will use the reporting framework that a specific investor prefers. But whichever framework an investor prefers (SASB, TCFD), it appears that investors increasingly want to see an assessment of the current ESG practices of a company, and commitments to improve upon the current assessment.

And while the focus of this document is U.S.-based, it is worth noting here that the global landscape for climate disclosure frameworks for capital markets is decidedly non-harmonious. Currently, the Canadian Securities Administrators (CSA), the International Sustainability Stan-

9 https://corpgov.law.harvard.edu/2022/11/10/esg-ratings-a-call-for-greater-transparency-and-precision/
10 It also appears that the SEC's current rulemaking has much in common with the TCFD framework.

dards Board (ISSB), and as mentioned above, the U.S. Securities and Exchange Commission (SEC) have all released various draft proposals around how climate risks should be disclosed. These proposals are not uniform in approach.

Global capital markets will continue to seek harmonization in climate disclosure framework reporting, but to date it appears that the process will be an uphill battle as there are still significant political challenges to the process.

While there are several country/region/industry-based frameworks around the world that are likely being used by many agencies and agency clients, it might be comforting to know that for frameworks agencies themselves are using in the U.S., there are really four main frameworks: Global Reporting Initiative[11] (GRI), Sustainability Accounting Standards Board[12] (SASB), United Nations Global Compact[13] (UNGC), and Task Force on Climate-related Financial Disclosures[14] (TCFD).

TCFD: As discussed above, both SASB and TCFD are very oriented towards financial materiality reporting metrics, and for that reason they tend to be more the province of publicly-traded companies. While SASB provides a somewhat backward-looking snapshot of sustainability performance, TCFD tends to focus more on the organization's future approach to sustainability and climate change, and assessing an organization's readiness regarding the associated risks and opportunities. The TCFD was created in 2015 by the Basel, Switzerland-based Financial Stability Board[15]. In 2020, approximately 1505 companies reported using the TCFD framework.[16]

SASB: SASB was originally founded as a non-profit organization in 2011. In August of 2022, the International Sustainability Standards Board (ISSB) assumed responsibility for the SASB standards. SASB announced in 2021 that more than half of the S&P Global 1200 use the SASB standards.[17] Similar to TCFD, SASB focuses on issues of reporting climate risk and financial materiality. (Note that there are currently underway efforts to try and consolidate some reporting, including aspects of SASB).[18]

GRI: GRI is the oldest of the four frameworks, founded in 1997[19], and claims to have 82% of the world's largest 250 corporations reporting in accordance with its GRI standards. In 2016, GRI transitioned from providing guidelines to companies, to setting global standards for reporting. GRI has recently started focusing on biodiversity impact reporting.

United Nations Global Compact: The UN Global Compact was developed out of voluntary CEO commitments to implement and advance the UN's Sustainable Development Goals, or SDG's. While the SDG's themselves are seventeen distinct goals[20], the UN Global Compact itself is distilled down to ten principles[21] intended for incorporation into companies' value sys-

11 https://www.globalreporting.org/
12 https://www.sasb.org/
13 https://www.unglobalcompact.org/
14 https://www.fsb-tcfd.org/
15 https://www.fsb.org/about/
16 Reported in The 2021 State of Green Business Report.
17 https://www.corporatesecretary.com/articles/esg/32723/more-half-sp-global-1200-using-sasb-framework
18 https://www.valuereportingfoundation.org/
19 Interestingly, GRI traces its founding directly to the Exxon Valdez oil spill in Prince William Sound, Alaska.
20 https://sdgs.un.org/goals
21 https://www.unglobalcompact.org/what-is-gc/mission/principles

tems and business operations. The UN Global Compact is perhaps the most "flexible" of the frameworks, as it appears to give companies wide discretion as to how, and to what degree, they attempt to implement the principles.

At present in the U.S., usage of any ESG reporting framework is voluntary, i.e. it is not mandated by any regulatory body, although that could change (not just because of the SEC, but you could see state, city, etc. requirements in the future). Many companies use more than one of the frameworks listed above.

For non-public companies[22] that don't have the need for highly-detailed investor disclosures, many companies, including many agencies, have embraced B-corp certification.[23] While it's debatable whether or not B-corp certification can be considered a "framework" in the same context of some of the other frameworks discussed here, it appears to be a popular option with non-public companies that want to go about establishing their ESG footprints in a rigorous fashion, as B-corp certification is a lengthy process that prioritizes continuous improvement.[24]

AGENCY CALLOUTS

- While usage of ESG reporting frameworks is still voluntary in the U.S. for now, substantiated adherence to a framework such as TCFD or SASB (or both) might be a requirement for a publicly-traded agency for purposes of receiving an ESG rating, or the requirement of a specific investor.
- For many non-public agencies, straight adherence to one of these frameworks such as GRI or UN Global Compact might be overkill, and an agency could be better served by working with an ESG Reporting Platform to help them understand their current ESG profile, including how to improve it. As this seems to be the direction that clients are starting to move towards, it's an area agencies should consider exploring before being presented with new terms requiring it from clients. Additionally, many of the ESG reporting platforms will incorporate aspects of GRI and UN Global Compact into their assessments/methodologies.

3 ESG Reporting Platforms

The term "ESG reporting platforms"[25] is going to be used somewhat generically here to cover a wide-range of software-based reporting platforms that have sprung-up in the past few years to facilitate ESG data metrics reporting and sharing. And while some of these software platforms are fairly new but dedicated to ESG and have gained significant market traction (i.e. EcoVadis, etc.), others are increasingly "add-ons" to legacy software companies with data storage space to spare.

22 B-corp certification can be attained by public and non-public companies, although current participants seem weighted towards non-public companies.

23 https://www.bcorporation.net/en-us/certification

24 Part of the B-corp certification process is substantiating a company's carbon footprint, and then improving upon it

25 Some ESG reporting platforms are also ESG ratings providers. There's a lot of overlap in this space.

Given the relative newness of so much of this market, it's difficult to know how many players there really are in this space, or even what exactly the differentiation is between the numerous providers. Some platforms appear to offer higher engagement via a customized questionnaire seeking to establish current ESG practices as well as recommending a path to improvement, while other platforms appear to be little more than allowing for ESG data to be input, and then easily shared with any third parties requesting it.

Some of these reporting platforms have unique sustainability assessment methodologies baked into their initial questionnaires, and it appears that several of these methodologies incorporate many aspects of existing reporting frameworks like GRI, UN Global Compact, etc., as well as standards like ISO 26000[26], etc.

It also appears that many ESG reporting platforms likely integrate directly with ESG reporting frameworks for simplified reporting, but it doesn't appear that all ESG reporting platforms have that capability. If an agency requires that capability, it's a question to ask at the beginning of the process.

At present, there doesn't appear to be any widely-available comprehensive guide to all the possible ESG reporting platforms available to companies. Given the growth of the market that's probably going to change soon, but in the meantime, companies are left having to rely on a lot of individual sleuthing and word-of-mouth recommendations. Again, given the growth of this market, there could be dozens to over a hundred different ESG reporting platforms, from the general to the industry-specific.

With that in mind, below is a brief highlight of two of the ESG reporting platforms that agencies are specifically being requested to use by clients.[27] Note that the majority of ESG reporting platforms appear to be for-profit companies (CDP is an exception).

EcoVadis: EcoVadis[28] is a sustainability assessment methodology software reporting platform that provides participating companies with an initial sustainability assessment based on reported information, recommendations for improvement, and an easy way to share this information with any third parties requesting it. EcoVadis assesses four key factors including environment, labor & human rights, ethics, and sustainable procurement.

EcoVadis currently claims to have over 100,000 companies participating, from over 175 countries, representing over 200 different industries. EcoVadis has a sliding scale of fees based on company size and desired level of feedback and outward communication. Additionally, EcoVadis offers various types of certifications.

Carbon Disclosure Project (CDP): CDP[29] is a not-for-profit organization for investors, cities, companies, states and regions to manage their environmental impacts. CDP currently works with over 3,700 North American companies (18,700 companies globally) to facilitate disclosures around climate change, water security and forests.

---

26 ISO 26000 is a standard developed by the International Standards Organization around social responsibility. It's guidance rather than requirements, so it can't be certified against, but it's still used as a basis for other uses, including supporting adherence to other frameworks like UN Global Compact. https://iso26000.info/iso-26000-an-introduction/

27 Note that neither of the listed platforms should be construed as endorsements by the 4A's.

28 https://ecovadis.com/

29 https://www.cdp.net/en

Over 200 cities, states and regions use CDP for disclosures. Companies are generally asked to disclose to CDP either through investors or customers. Companies are then asked to complete a questionnaire around climate change, water security and forests. This information is then shared with requesting investors and customers. CDP questions are aligned with TCFD. Note that CDP has a defined submission period for companies.

CDP has a sliding administrative fee structure based on geographic location and different factors including the basis of the request for participation (i.e. investor request, etc.).

AGENCY CALLOUTS

- Agency clients, existing and potential, are increasingly asking their agencies to report their ESG data to an ESG reporting platform. While there are many different ESG reporting platforms in the market, the two that agencies appear to date to be getting the most requests for from clients are CDP and EcoVadis. To date, both these platforms appear to have the benefit of time in market and broad cross-industry adoption, but this is far from a mature market and subject to ongoing evolution.
- Another point for agencies to consider is that the White House has released a rulemaking to require federal contractors to publicly disclose their Scope 1, 2, and 3 emissions[30]. For federal contractors who have not yet begun the process of establishing their emissions footprint, working with an ESG reporting platform could be a good way to satisfy this requirement (although, the final rules for what compliance looks like will be forthcoming). It looks that companies that choose to use CDP might be in compliance with what the White House is looking for under the new rule.[31]
- The process of information gathering for reporting can be very time consuming. For agencies looking to get started, many of the reporting platforms offer a "checklist" of what types of documents to have ready before starting. As many reporting platforms are asking for the same information, having those documents ready to go (and knowing what cycles they're updated on) will help to streamline the process.
- Another point for agencies to consider is that with growing requests from clients and new pressure from the White House, the services of ESG reporting platforms are increasingly in-demand. The wait times involved in the process do appear to be increasing due to the increased demand, so agencies considering getting involved would want to consider getting in the queue sooner rather than later.
- The growing complexity of the ESG reporting platforms marketplace could be a good opportunity for agencies to provide new services to clients seeking to understand this marketplace, and in helping clients find the best solution for their unique needs.

30 https://www.whitehouse.gov/briefing-room/statements-releases/2022/11/10/fact-sheet-biden-harris-administration-proposes-plan-to-protect-federal-supply-chain-from-climate-related-risks/

31 https://www.cdp.net/en/articles/media/in-bold-new-move-biden-administration-makes-cdps-model-the-law

CONCLUSION

Given the increasing pressure on global and domestic companies to respond to the growing issue of sustainability, the issues around understanding the ESG landscape will continue to expand. And while other geographic regions around the world are starting to initiate new rules of the road in the form of climate legislation and regulation, the U.S. to date has still been largely a voluntary market in this space.

And while that might change in the wake of some upcoming legislative changes and regulatory rulemakings underway in the U.S., it still remains likely for the time being that U.S. companies will be primarily driven via their relationships with customers, partners, investors, etc.

For now, many of the efforts taking place in the ESG space are working to bridge that gap between the lack of formal guidance and the desires of companies to want to step-up and proactively be better actors. For agencies that might need more guidance, there are a wide-range of ESG consultants available who can help any agency with a more in-depth review of current ESG practices, and help them along their ESG journey.

Agencies have an incredible opportunity here to help guide their clients, their partners, and their own companies through a very complex area in a way that ultimately drives to where all these complex ESG efforts are trying to go - to establishing, and more importantly, improving on key ESG metrics in way that will make a net positive impact.