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Think tank takes ESG rating agencies to task

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The American Council for Capital Formation is questioning the ratings process used for ESG investments.

In a report released Thursday, the Washington-based, business-backed think tank argued individual companies "can carry vastly divergent (ESG) ratings from different (ESG rating) agencies simultaneously, due to differences in methodology, subjective interpretation or an individual agency's agenda."

"There are also inherent biases: from market-cap size, to location, to industry or sector — all rooted in a lack of uniform disclosure," the report stated.

The major ESG ratings agencies analyzed in the report are MSCI, Sustainalytics, RepRisk and ISS. Concerns raised by the ACCF over the agencies' ESG rating methodologies included variances in scoring systems among the agencies and the agencies' not fully disclosing the indicators they evaluate or the material impact of the indicators.

The ACCF report also raised concerns over rating agencies using companies' self-reported and unaudited sustainability reports to form their analyses: "Self-reported and unaudited sustainability reports invariably present companies in the best possible light, and rarely do they alert investors of looming problems."

The report goes on to state ESG rating agencies need to "adjust their rating methodologies to address different quantities of information from a geographic and industry-specific level."

"Rating differences can be the result of unequal information availability," the think tank suggests.

ACCF pointed to RepRisk and Sustainalytics' ratings of Bank of America as an example of how different rating agencies can disagree when evaluating the same company.

While both agencies factored similar issues at Bank of America into their ratings, BofA earned a below-average ESG score from RepRisk and well above average ESG score from Sustainalytics, the report said.

Alexandra Mihailescu Cichon, executive vice president of sales and marketing for RepRisk, said in an emailed statement that the ACCF's characterization of RepRisk as an ESG ratings agency is incorrect.

According to Ms. Cichon, RepRisk is an ESG data science firm that provides "research and business intelligence to identify and assess risk incidents."

Also, RepRisk does not look at companies' disclosures to evaluate their risk exposures; rather, it looks at what is disclosed externally by the media, stakeholders and other public sources, she said.

Ms. Cichon said RepRisk "shares many of the report's concerns about ESG ratings," including ratings driven by companies' self-reporting and a lack of consistency and transparency in methodology.

"RepRisk's methodology is systematic and fully rules based," Ms. Cichon said. "We have a consistent methodology since we launched our research in January 2007, which means we have an unbroken time series of data. We are also fully transparent about our methodology, any client can receive details on the research process and algorithms."

Officials at the other companies could not immediately be reached for comment on the report.

The full report is available on the ACCF's website.