

ESG ratings at a crossroads: an expert's guide for companies

In a conversation with sustainable finance executive **Manjit Jus**, we explore the challenges and future direction of ESG ratings, shedding light on their implications for companies and rating agencies alike.



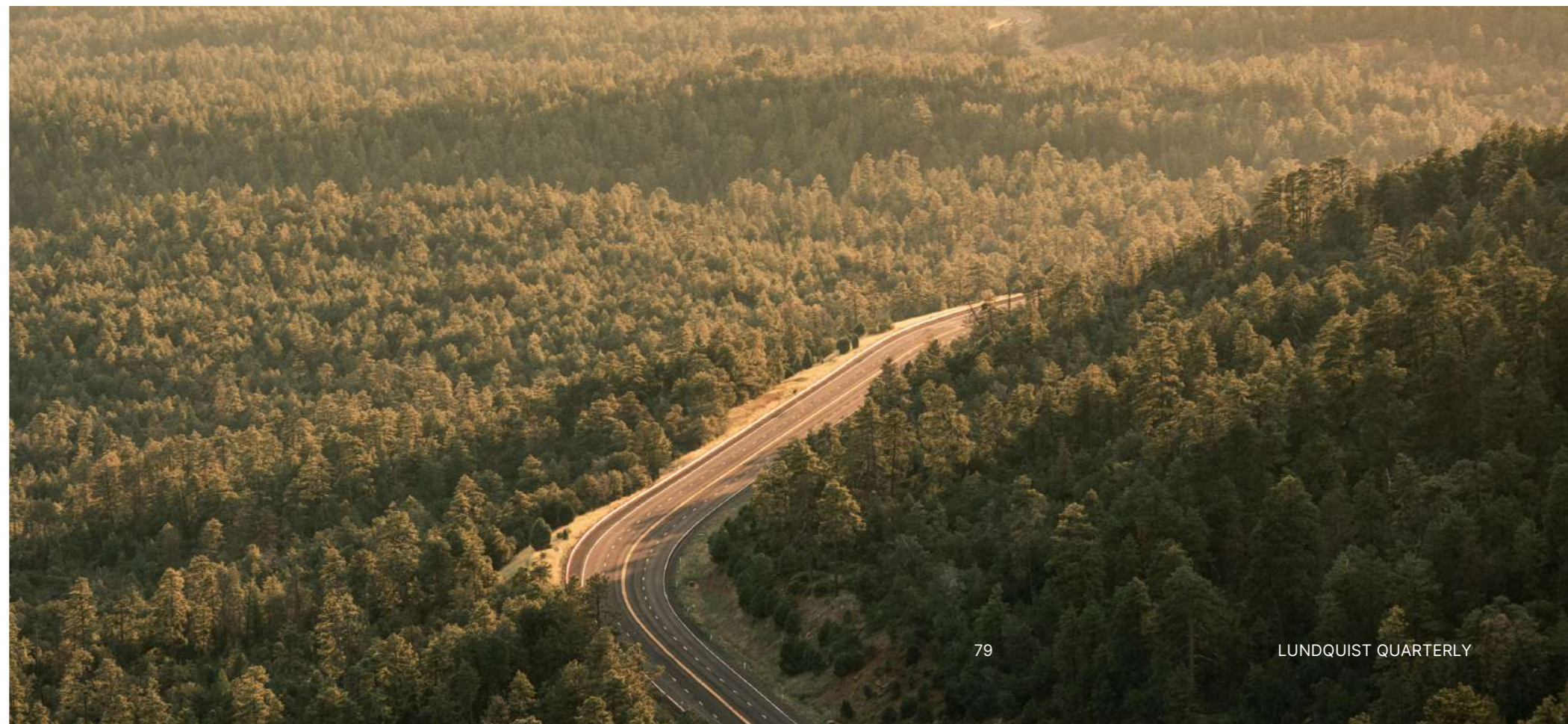
Interview by **JAMES OSBORNE**
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THE LATEST "RATE THE RATERS" RESEARCH BY THE SUSTAINABILITY INSTITUTE, WHICH HAS BEEN TRACKING INVESTOR AND CORPORATE PERCEPTIONS OF ESG RATINGS FOR OVER A DECADE, SAYS THE INDUSTRY IS AT A CROSSROADS. ON THE ONE HAND, DEMAND FOR ESG DATA CONTINUES TO GROW WHILE, ON THE OTHER, THERE IS POLITICAL BACKLASH (IN THE U.S. ESPECIALLY) AND GROWING CALLS FOR HIGHER TRANSPARENCY AND CONSISTENCY. ON BALANCE, HOW DO YOU RATE ESG RATINGS?

MJ For many years, ESG ratings have gotten away with not being transparent and lacking clarity about their meaning. There is now an urgent need to be more open with a wider audience. ESG ratings and the infrastructure around them play a crucial role in translating complex data into something both investors and companies can actually use.

The role of ESG ratings providers in cleaning data and making it precise as well as useable should not be underestimated. You would be surprised about how much time and effort providers of these ratings invest into cleaning and refining publicly available data. Currently, there's a lack of accountability for data quality, and ESG ratings bridge this gap.

"As a company, I would focus on the key topics that matter to your stakeholders. Engaging with the right stakeholders on the right topics, while fulfilling regulatory requirements will be key."



COMPANIES ARE HAVING TO RESPOND TO A DELUGE OF DIFFERENT DEMANDS FOR DISCLOSURE AND TRANSPARENCY. THAT'S PARTLY DUE TO REGULATION BUT ALSO BECAUSE OF THE FRAGMENTED NATURE OF THE ESG INDUSTRY WITH MULTIPLE ORGANISATIONS ASKING FOR DIFFERENT INDICATORS. IF YOU WERE HEAD OF ESG OR INVESTOR RELATIONS FOR A MAJOR LISTED COMPANY, HOW MUCH TIME AND EFFORT WOULD YOU DEDICATE TO ESG RATINGS? HOW MUCH SLEEP WOULD YOU LOSE OVER THEIR JUDGEMENTS?

MJ We're in a phase when people are just chasing things, investors responding to clients, companies to stakeholders. It becomes a vicious cycle of collecting and reporting data and people struggle to find that space to reflect on the "why". Therefore, it is important for companies to take a step back and assess what's important to the business.

For example, after over a decade of close engagement with one of Europe's biggest consumer goods companies, they called us to say that they would no longer be actively engaging in our research process. They appreciated the many years of collaboration and thanked us for pushing the agenda on underreported sustainability topics which helped them mature their strategy. At the same time, they believed that they had spent a lot of time getting their

public reporting to a point where it fulfilled most stakeholder needs and were now going to focus their resources on executing their sustainability strategy. I wouldn't worry too much about ESG ratings: they are an important component of sustainability investing and will likely continue to be a useful starting point for investors. Increasingly the focus is on the underlying data that is being used, so getting the data right should be the focus. Increasingly, company-reported data is being supplemented by other data that provides a more "outside-in" view of a company.

What's more, this kind of external data is authoritative and can therefore help address concerns about greenwashing from company-reporting data only. At the end of the day, an ESG rating is an opinion, and as the methodologies behind these ratings are forced to become more transparent, hopefully the ratings become less of a headache for the markets. Increased regulation on ESG ratings may further align rating approaches, which could potentially reduce the reporting burden on companies and confusion about what the ratings mean.

At the same time, regulation will drive more transparency which should allow users of ratings and the underlying data to ask better questions directly to companies. Investors are getting wiser and have their own dedicated ESG teams and specialists internally.

"The trend toward more democratized and freely available ESG data hopefully leads to improved data quality in the long run and increased accountability in reporting. This is crucial for combating greenwashing practices."

IT WOULD BE GOOD AT THIS POINT TO CLARIFY OUR TERMINOLOGY: ESG AND SUSTAINABILITY! AS WE SEE IT, ESG HAS BEEN OVER-INFLATED AND ALSO BECOME POLITICALLY LOADED. AT ITS CORE, IT'S THE FINANCIAL INDUSTRY'S ACRONYM FOR NON-FINANCIAL TOPICS THAT CAN BE USED TO SUPPORT INVESTMENT DECISIONS AND RISK MANAGEMENT STRATEGIES; CORPORATE SUSTAINABILITY, ON THE OTHER HAND, IS ABOUT MANAGING THE REAL-WORLD IMPACTS OF DOING BUSINESS GIVEN ENVIRONMENTAL THRESHOLDS AND THE SOCIAL CONTEXT. WHAT'S YOUR TAKE?

MJ It's a very emotional space right now, terminology means different things to different people. It's easy to start by having a rational discussion about the topic but then get lost in people's emotional responses, with people talking past each other. I think this is where a lot of the frustration stems from, and where there are huge inefficiencies in making progress towards real impacts.

It needs to become more intentional: EU labelling rules, taxonomy, etc. can create clarity, and provide fixed points for discussions. It's crucial to eliminate greenwashing and emphasize meaningful impacts rather than allowing terminology to make us focus on the wrong things.

We run the same risk with the CSRD if it's seen as a burden to companies, who risk then becoming frustrated with the process and question its purpose. It should serve as a catalyst for improving business practices. It shouldn't be about ticking the "sustainability" box, it needs to drive business value and tangible impacts.

LOOKING TO THE FUTURE, WHERE DO YOU FORESEE THE ESG RATINGS SECTOR HEADING? IT SEEMS LIKE TECHNOLOGY AND ARTIFICIAL INTELLIGENCE ARE ALREADY CHANGING THE GAME.



MANJIT JUS

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Manjit is an experienced sustainable finance executive, having worked with corporate and investment clients for more than a decade. He began his career at sustainable investing pioneer SAM (now Robeco) where he helped build and lead one of the most comprehensive ESG research and ratings frameworks globally – the Corporate Sustainability Assessment, which powers the world-renowned Dow Jones Sustainability Indices.

In his most recent role at S&P Global he oversaw the ESG Research function globally, leading a team of 350+ sustainability professionals in the field of research, data and technology.

MJ Looking ahead, the ESG ratings sector will gradually experience a transformation with the increasing democratization of ESG data driven by technology. This shift may disrupt traditional business models for some rating firms. Simultaneously, increased regulation, particularly in Europe, is driving the demand for more transparent research, aiming to eliminate biases and conflicts of interest.

We're at a pivotal moment with a crucial question about the relevance of ratings agencies in the evolving landscape. Their ability to innovate while becoming more transparent and retaining their "secret sauce" at the same time will be key. Maintaining strong partnerships with companies and investors is vital for these agencies to remain influential and avoid falling out of favour.

