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September 6, 2021

The Board of the
International Organization of Securities Commissioners (IOSCO)

Re: Public Comment on ESG Ratings and Data Products Providers[1]

Dear All,

My name is Bill Harrington. I am a private U.S. citizen, pro-bono advocate for responsible finance, and member of the Wikirating Experts Board.[2]

I am also a senior fellow affiliate at Croatan Institute. Croatan Institute is an independent, nonprofit research and action institute whose mission is to build social equity and ecological resilience by leveraging finance to create pathways to a just economy. We envision an equitable world where finance supports flourishing communities, vibrant places, and resilient economies.[3]

I inject accountability into the U.S. and global financial systems by pushing financial practitioners and regulators to *vastly* improve governance. My goals are to rationalize financial systems, optimize economies, and re-constitute social contracts. Financial practitioners' poor governance undermines everyone in the world by relentlessly warping price signals, directing investment to sub-optimal uses, and periodically spawning full-blown crises.

I take aim at two pervasive governance failures that generated the 2008 financial crisis, namely:

1. Credit rating inflation of bonds, issuers, and derivative counterparties in all sectors; and
2. Proliferation of deficient complex-finance products such as derivative contracts and asset-backed securities (ABS) that enable an entity to overstate potential gains and understate potential losses.[4]

PLEASE NOTE:

***Do Not Scrub My Contact Details!* I intentionally place them and all my work in the public domain because I welcome *all* inquiry from *all* persons, both human and corporate.**

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1 IOSCO, "Environmental, Social, and Governance (ESG) Ratings and Data Providers", *Consultation Report*, July 2021 ("IOSCO Proposal"). (https://www.iosco.org/library/pubdocs/pdf/IOSCOPD681.pdf).

2 Wikirating website (https://www.wikirating.org/).

3 Croatan Institute website (http://croataninstitute.org/).

4 Ibid., "Injecting Accountability into the U.S. and Global Financial Systems" and "Bill Harrington" bio.

MAIN POINT: IOSCO and its members must not direct ESG analytics providers on how to govern themselves

> *"IOSCO must first fix its own poor governance and, second, wait a good long while before establishing governance guidelines for providers of ESG ratings and data products."*
>
> *"ESG analysis is a nascent discipline that needs time, space, and open-ended public dialogue with the whole wide world to define the most useful sustainable practices and then evaluate them."*
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> — Bill Harrington, "IOSCO should back off ESG ratings providers,"
> *Environmental Finance*, 19 August 2021.[5]

Croatan Institute posted a later version of my *Environmental Finance* op-ed as a *Croatan View* on August 30, 2021.[6] It follows immediately below.

IOSCO Should Back Off ESG Ratings & Data Providers

Note: *Environmental Finance* posted an earlier version of this View as "IOSCO Should Back Off ESG Ratings Providers" on August 19.

IOSCO and its members must not direct ESG analytics providers on how to govern themselves.

IOSCO and company must first fix its own poor governance and, second, wait a good long while before establishing governance guidelines for providers of ESG ratings and data products.

ESG analysis is a nascent discipline that needs time, space, and open-ended public dialogue with the whole wide world to define the most useful sustainable practices and then evaluate them. Regrettably, IOSCO recommends that ESG information providers hurry up and emulate credit rating agencies such as Fitch Ratings, Moody's Investors Service, and S&P Global Ratings by instituting robust *processes* as an end in themselves rather than a means to producing robust *content*. See the IOSCO "Consultation Report "Environmental, Social and Governance (ESG) Ratings and Data Products Providers" of July. Responses are due September 6.

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[5] Available at: https://www.environmental-finance.com/content/analysis/iosco-should-back-off-esg-ratings-providers.html.

[6] Harrington, Bill, "IOSCO Should Back Off ESG Ratings and Data Providers", *Croatan View*, August 30, 2021. (https://croataninstitute.org/2021/08/25/iosco-should-back-off-esg-ratings-data-providers/).

The IOSCO recommendation is itself a massive *governance* failure that mimics and reinforces a predecessor *governance* failure, namely the [2015 IOSCO "Code of Conduct Fundamentals for Credit Rating Agencies"]”.

If adopted in current form, the IOSCO recommendations for ESG analytics providers will undermine ESG analytics and sustainability practices in at least two ways:
(1) Providers will be incentivized to dilute ESG content in ESG analytics as comprehensively as credit rating agencies have diluted credit content in credit ratings.
(2) ESG analytics will ossify, rather than evolve organically to suit as many entities around the world as possible.

IOSCO members, such as the US Securities and Exchange Commission (SEC), zealously "regulate" credit rating agencies in accordance with the IOSCO credit rating blueprint. Collectively and individually, the blueprint undermines economies and financial systems by greenlighting credit rating agencies to assign credit ratings that buttress commercial interests at the expense of analytical robustness.

Propelled by the IOSCO blueprint, credit rating agencies inflate the credit ratings of constituent entities and sectors, which in turn distorts debt prices to favor credit rating agency cronies and disadvantage projects with maximum utility. As big-picture corroboration, consider the endemically disappointing economic growth that major economies recorded after 2008 even as the market for credit-rated debt mushroomed.

The IOSCO ESG recommendation and credit rating blueprint both unravel at the first step, namely taxonomy. Business enterprises such as Fitch Ratings, Moody's Investors Service, and S&P Global Ratings, and not government "agencies" or regulated utilities, develop credit rating methodologies, assign new credit ratings, and monitor existing ones. The term "credit rating company" is both more accurate than "credit rating agency" and more instructive on the primary driver of unreliable credit ratings—namely, the unrelenting push by the ultimate owner of each credit rating business to maximize franchise earnings.

Likewise, both the IOSCO ESG recommendation and credit rating blueprint unravel at first inspection, as well as deep review. Neither IOSCO document offers credible mitigation for the business owner conflict of interest. Instead, both documents harp on the much posited but unconvincing premise that rogue analysts and managers are the main distorters of information, be it credit ratings, ESG ratings, ESG credit ratings, or other ESG data products. As a result, the IOSCO ESG recommendation, like the IOSCO credit rating blueprint, tasks business owners of ESG analytics providers to clamp down on potentially rogue staff by establishing *processes and procedures* for developing the analytics. Conspicuously absent from both blueprints are constraints on the ultimate business owners or reviews of analytical content.

The absences are intentional. IOSCO and members disingenuously claim that "free markets" preclude meaningful regulation of analytical business owners and that "free speech" precludes all regulation of content, including demonstrably flawed ratings, methodologies, and other products.

Tying the regulatory gap back to ESG analytics, Fitch Ratings, Moody's Investors Service, and S&P Global Ratings *transparently* leverage their free speech to post and cite *transparently* toothless credit rating methodologies that hoodwink users into believing that credit ratings incorporate the credit exposures of ESG factors.

Upping the misrepresentation, the credit rating companies' respective parents are extending their oligopoly into the ESG analytical sector by acquiring formerly independent providers. What might be a system of reliable information is morphing into a mutual admiration society in which neither credit rating companies nor ESG analytical providers critique each other's products.

I submitted a comment on ESG exposures to the SEC on June 14 that urges the regulator to fix its governance and that of credit rating companies. A good start is to immediately end the charade that the content of credit ratings and methodologies are subject to any scrutiny, let alone meaningful scrutiny. In short: Credit rating users, beware! Be fully aware!

Likewise, IOSCO and members must not direct ESG analytics providers on how to govern themselves unless the goal is to undermine all forms of sustainability as quickly as possible.

Bill is spending the next year living in a variety of East Coast locales. **To learn more about Bill and his ten-year, to-date self-funded research advocacy, please see his bio.**

NO Oversight of ESG Analytics Providers is VASTLY Preferable to "Oversight" that Mimics That of Credit Rating Companies

The Nationally Recognized Statistical Rating Organization (NRSRO) scheme that the SEC operates, and IOSCO blesses, is a systemic disaster. Failed NRSRO governance undermines everyone by relentlessly warping price signals, directing investment to sub-optimal uses, and periodically spawning full-blown crises.

NRSRO "management of conflicts of interest" plies the conflicts to maximize franchise earnings and maximize financial sector earnings.

The primary purpose of the NRSRO scheme seems to be the maximization of holding company earnings by the ultimate owner of each NRSRO. A side effect that all but shuts down criticism by other financial practitioners is that the NRSRO scheme also maximizes earnings in the maximum number of financial sectors, including but not limited to accounting, auditing, banking, consulting, data, credit analysis, equity analysis, investing, issuance, legal, and underwriting.

Because IOSCO perpetuates NRSRO clones that gut investor protections globally, there is negative "value in IOSCO playing a role to provide this [ESG] guidance."

A primary purpose of IOSCO-blessed credit rating schemes worldwide seems to be perpetuation of failed, crisis-causing structures that birthed and pro-longed the 2008 financial crisis, most prominently ABS and structured products that are parties to an unmargined swap contract that references a flip clause.[7] Perpetuation of the failed structures is a such a colossal governance failure by IOSCO and members that none have standing to propose or oversee *governance* of other entities, least of all ESG analytics providers.

NRSROs omit credit exposures to ESG factors from credit ratings and broadcast the ESG omissions via "defined methodologies" with "high levels of transparency."

ESG ups the NRSRO tax on everyone by providing credit rating companies with a pretext to comprehensively wreck social and natural systems by whitewashing both their own governance failures and those of rated entities that greenwash. Make no mistake. The SEC, by way of its NRSRO scheme, spurs Fitch Ratings, Moody's Investors Service, and S&P Global Ratings to *intentionally* underestimate credit exposures to ESG factors as thoroughly as the companies intentionally underestimate mainstream credit exposures such as unmargined swap contracts.

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7 Harrington, William J. "Electronic Letter to CFTC, SEC, LSTA, SFA, DBRS, Fitch, Moody's and S&P 'Re Deficient Accounting, Capitalization, Credit Ratings, and Regulation of EVERY Party to a Swap Contract with a Flip Clause or Other Walk-Away Provision'," December 28, 2020. (20201228 Harrington J William Flip Clause Questions to CFTC-SEC-LSTA-SFA-DBRS-Fitch-Moodys-S&P.pdf (wikirating.org)).

<u>ESG and Credit ANALYSIS Have NOTHING in Common (Except Same Few Oligopolistic Owners)</u>

Imposing NRSRO processes on ESG analytics providers will erode the social and natural systems that ESG practitioners work to bolster. ESG analytical products on the one hand and credit ratings on the other hand differ so fundamentally for at least three major reasons that the respective decision-making processes should also fundamentally differ.

1. ESG ratings and data products are intended to be *transformative* and descriptive whereas credit ratings are intended to be primarily *descriptive*. ESG practitioners and advocates want every entity in the world to continually boost social and natural systems and, consequently, to improve ESG ratings and evaluations. In contrast, there is no reason for a debt issuer to adopt the credit profile of a higher-rated entity. All credit profiles other than immediate default are valid goals. As a hypothetical example, every stakeholder of an entity with an accurate credit rating of "BBB" may be best served by the entity preserving operating and capital strategies rather than changing them simply to obtain a higher credit rating.

2. ESG analysis that pertains to climate must be calibrated to a degree of specificity that is orders of magnitude more acute than the very gross categories that comprise the full range of NRSRO credit ratings — typically no more than 20 possible ratings.

3. ESG analytics is susceptible to grade inflation on a much larger *scale* than mainstream credit ratings because entities that invite ESG scrutiny often want "best-in-class" designation. In contrast, entities that push for credit rating inflation settle for a plausible amount of unwarranted improvement, e.g., rating inflation of one-to-two credit rating notches, because that generally suffices to optimize financing and reputation benefits. In contrast, more pronounced rating inflation can backfire spectacularly by calling to mind crisis-era products, such as AAA-rated, private-label residential mortgage-backed securities and collateralized debt obligations that were parties to an unmargined swap contract with a flip clause. In the hypothetical example above, an entity that deserves a credit rating of "BBB" will be satisfied with obtaining a moderately unwarranted credit rating of "A" rather than a blatantly implausible, best-in class "AAA".

<u>Keeping Spotlight on NRSRO Worst-Practice, Business-as-Usual, "Governance"</u>

This submission copies six staff of Fitch Ratings, Moody's Investors Service, and S&P Global Ratings whom I regularly provide with analyses. None address my critiques or engage with me despite five of the six having global ESG responsibilities at their respective NRSROs. The sixth oversees reporting to the U.S. Department of Justice and the attorneys general of 21 states and the District of Columbia per a 2017 settlement.

None of the six copied NRSRO staff work to improve their respective NRSRO's governance or boost the credit content of credit ratings and methodologies. In my experience, the six staff deploy SEC and IOSCO-ordained *processes* and unfettered freedom of speech to dilute the credit content of credit ratings and credit rating methodologies.

For instance, NRSROs *do* follow IOSCO-recommended processes in soliciting public comment when proposing new and updated credit rating methodologies, including ones that address credit implications of ESG factors. Similarly, NRSROs *do* follow IOSCO-recommended processes by generally posting every comment that a submitter designates as public on their respective websites.[8] At the same time, NRSROs use unfettered freedom of speech to ignore comments that call for more rigorous credit rating methodologies, i.e., ones that will mandate credit rating downgrades.

As recent examples, Fitch Ratings and S&P Global Ratings use commercial discretion to deny me access to their respective websites, thereby preventing me from obtaining methodology proposals to critique in the first place. Moody's *does* allow me access to its website and accepts critical comments that propose more rigorous methodologies, such as the respective comments on ESG credit rating methodologies that Sierra Club and I filed in October 2020.[9] However, Moody's also uses unfettered free speech to misrepresent and entirely ignore critiques in the posted summary of comments that itemizes rationales for each finalized methodology.[10] The result is that Moody's, like Fitch and S&P, ends up approving credit rating methodologies that preserve or upgrade credit ratings, not downgrade them.

This submission copies 13 staff of SEC Commissioners and the SEC Office of Credit Ratings whom I have regularly provided with analyses, in some cases since 2011. The fact that neither the SEC nor any NRSRO addresses my critiques or engages with me is emblematic both of their respective governance failures and of why ESG analytics providers must operate very differently. On the

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8 Moody's Investors Service ESG team proved an exception. I submitted a public comment on its global credit methodology proposal for ESG on October 22, 2020, but Moody's provided a *bogus* link to my comment until December 17, 2020. Harrington, Bill, "Re Please Make My ESG Comment Response Publicly Available", Message to Mr. Swami Venkataram, Senior Vice President - Manager, ESG Analytics and Integration at Moody's Investors Service, and Mr. James Leaton, Senior VP - ESG - Climate Risk at Moody's Investors Service, December 16, 2020, Email. Croatan Institute has provided a *valid* link to my comment since October 22, 2020. (https://croataninstitute.org/wp-content/uploads/2021/08/WJH-Response-to-Moodys-Investors-Service-Request-for-Comment-General-Principles-for-Assessing-ESG-Risks-1.pdf).

9 For the respective critiques by the Sierra Club and me, see Moody's Investors Service, "Request for Comment Responses, 'General Principles for Assessing Environmental, Social and Governance Risks: Proposed Methodology Update, Publication Date: 23 Sep 2020'", Accessed September 2, 2021. (https://www.moodys.com/RFC/response/ViewComments/UEJDXzEyNDM0NTQ=).

10 As example, Venkataram, Swami, James Leaton, and Brian Cahill, "General Principles for Assessing Environmental, Social and Governance Risks: Proposed Methodology Update", *Moody's Investors Service Request for Comment / Results of Consultation*, December 14, 2020. (https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1243454).

most fundamental level, an ESG analytics provider must commit both to delivering best-practice products and to exercising best-practice governance. The two commitments are wholly intertwined, an ESG analytics provider cannot have one without the other. In turn, welcoming and engaging with critics is an indispensable component of best-practice governance by any entity, and particularly for an ESG analytic provider whose analyses must evolve in myriad directions to reflect ESG concerns and evolution around the world.

I counter SEC and NRSRO non-governance and non-engagement by always communicating for attribution and disseminating my work throughout the public domain. Media staff such as journalists and editors periodically seek my views and ask me to expand on them in op-eds, i.e., the journalists and editors perform best-practice governance by soliciting comment and content from best-practices sources such as me. Regarding ESG media, *Responsible Investor* requested and posted two of my op-eds in 2020.[11] As this submission cites, *Environmental Finance* requested and posted my August 19 op-ed. More recently still, a *Bloomberg* journalist sought my critiques of the ESG-void in NRSRO credit ratings. This submission copies *Environmental Finance* Editor Peter Cripps, *Responsible Investor* Editor Sophie Robinson Tillett, and *Bloomberg* Reporter Jill Ward.

The ongoing governance failures by NRSROs and the SEC convince me that the charade of SEC oversight, i.e., the entire NRSRO scheme, should be scrapped immediately. No oversight — credit rating users be fully aware of deficient credit rating content — is preferable to the NRSRO scheme of pretend oversight that fosters the illusion of robust content.

Likewise, ESG analytics providers. No oversight is preferable to the IOSCO proposal of pretend oversight. Because IOSCO perpetuates the NRSRO scheme and clones around the world, there is negative "value in IOSCO playing a role to provide this guidance."[12]

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[11] Harrington, Bill, "Moody's ESG overhaul won't have any actual effect on credit ratings . . .", *Responsible Investor*, October 19, 2020 (https://www.responsible-investor.com/articles/moody-s-esg-overhaul-won-t-have-any-actual-effect-on-credit-ratings) and "Investors who want to fast-track sustainable fixed-income investments should inundate credit rating agencies with methodology critiques", *Responsible Investor*, January 28, 2020 (https://www.responsible-investor.com/articles/investors-who-want-to-fast-track-sustainable-fixed-income-investments-should-inundate-credit-rating-agencies-with-methodology-critiques), respectively.

[12] "IOSCO Proposal", page 37. "Before determining whether it was appropriate for IOSCO to propose recommendations in this area, IOSCO canvassed the opinions of stakeholders to understand: (i) whether developments in the area of ESG ratings and data products providers pose risks to investor protection; ii) whether there are already existing standards or guidance in the market for ESG ratings and data products providers; and, (iii) **whether there would be value in IOSCO playing a role to provide this guidance** [emphasis added]."

IOSCO Fact-Finding Exercise Proves IOSCO Proposal is, at Best, Way Premature

The IOSCO fact finding exercise demonstrates that ESG analysis is in its infancy and needs years, and possibly decades, to develop organically before being codified.[13]

Perhaps codification should never occur, given that ESG analysis must evolve in as many directions as local conditions around the world require. In other words, lack of "clarity and alignment on definitions, including on what ratings and data products intend to measure", may be a virtue rather than an obstacle to bolstering social and natural systems. I can attest to the need for time to develop a useful governance tool, particularly when one operates in the non-profit sector.

In 2018, I proposed a "financial sustainability scale" — "a simple numeric scale that indicates the impact that a financial product or contract has on the sustainability of a financial system."[14] Much more time and resources will be needed to refine the methodology.[15] Much more time and resources will be needed to comprehensively populate the scale itself.[16] However, the scale presents important information.

> "*The proposed scale assigns score values in the range from -10 to +10, with the negative endpoint indicating an entirely destructive impact on a financial system and the positive endpoint indicating an entirely sustainable impact. A big-picture utility of a financial sustainability scale is to identify and limit the use of financial products that unequivocally harm financial sustainability. Prominent in the negatively-scored harmful category are products that have either prompted taxpayer bailouts or required them.*[17]

The lowest financial sustainability score of "-10" is assigned to a provider "of any 'flip clause swap' (an uncleared and non-margined swap with replacement provisions, rating agency conditions and a flip clause)". As of July 2018, providers included: Citibank, N.A.; JPMorgan Chase Bank NA; Morgan Stanley Capital Services; Royal Bank of Scotland; Deutsche Bank New York; Bank of America NA; Royal Bank of Canada, Toronto; Goldman Sachs Mitsui Marine Derivative Products LP; Bank of New York; Wells Fargo Bank; CDC IXIS Capital Markets; Natixis; Swiss Re Financial

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[13] Ibid., page 5: "The fact-finding exercise revealed that: there is little clarity and alignment on definitions, including on what ratings or data products intend to measure; there is a lack of transparency about the methodologies underpinning these ratings or data products; . . . there may be concerns about the management of conflicts of interest where the ESG ratings and data products provider or an entity closely associated with the provider performs consulting services for companies that are the subject of these ESG ratings or data products; . . ."

[14] Harrington, Bill, "Can Green Bonds Flourish in a Complex-Finance Brownfield?", *Croatan Institute Working Paper*, July 2018, page 1. (https://croataninstitute.org/2018/07/01/can-green-bonds-flourish-in-a-complex-finance-brownfield/).

[15] Ibid., Appendix I: Methodology behind the proposed financial sustainability scores, pages 30-31.

[16] Ibid., Table: Summary of Representative Financial Sustainability Scores for Products Described in this Working Paper, pages 32-38.

[17] Ibid., page 1.

Products; AIG financial Products Corp; Banque National de Paris; Barclays Capital Markets; and Credit Suisse First Boston International, and several Lehman Brothers entities.[18]

The lowest financial sustainability score of "-10" is also assigned to the issuers of spectacularly under-capitalized, overly complex financial deals with inflated credit ratings of "AAA". As of July 2018, 12 deals were assigned a "-10": "9 FFELP Student Loan ABS deals (medium-to-long swap final maturity)"; one "representative EU CLO with waterfall flip clauses and buckets to purchase assets in 2nd currency"; and "two representative repackaged securities."[19]

The same Table assigned a financial sustainability score of "+3" to a "theoretical ABS deal with NO potential depreciation from currencies, basis rates or interest rates." [20]

Finally, the same Table does not assign any type of deal a financial sustainability score ranging from "+4" to "+10".[21]

Regarding Recommendation 1: ESG ratings and data products need ZERO regulatory oversight

Regulators must step back and allow each ESG analytics provider to organically develop governance processes that allow it to create and deliver best-in-class products.[22]

NRSROs are a dead-end model for ESG analytics providers because NRSRO "corporate governance organizational and operational structures . . . are [emphatically not] sufficient to identify, manage and mitigate any conflicts of interest."[23] ESG analytics will devolve into damaging miasma if ESG analytics providers are obligated to adopt NRSRO-like procedures.

For instance, NRSROs follow IOSCO-blessed processes in posting *poor* credit rating methodologies, including for credit analyses of ESG factors. NRSROs also follow IOSCO-blessed processes in ensuring that credit ratings "are issued consistent with the relevant methodologies." The result is consistently poor credit ratings, i.e., credit ratings that minimize credit information rather than incorporate rigorous credit assessment. (" . . . ESG ratings and data products are issued consistent with the relevant methodologies." II ". . . processes underlying ESG ratings and

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[18] Ibid., Table: Summary of Representative Financial Sustainability Scores for Products Described in this Working Paper, page 32.

[19] Ibid., page 33.

[20] Ibid., page 38.

[21] Ibid.

[22] "IOSCO Proposal", page 40. "**Recommendation 1**: Regulators may wish to consider focusing more attention on the use of ESG ratings and data products and ESG ratings and data products providers in their jurisdictions." II "Regulators may wish to consider their existing regulatory regimes and consider whether they provide sufficient oversight of ESG ratings and data products."

[23] Ibid. Unless otherwise noted, all quotes are from Recommendation 1, pages 40-41.

data products are subject to written policies and procedures and/or internal controls to ensure they are rigorous, systematic, and applied in a continuous manner.")

Perhaps unwittingly, IOSCO and members corroborate the critique. IOSCO and members do *not* press *NRSROs* to develop "robust" methodologies for credit ratings, but the IOSCO Proposal does find that "the quality of ESG ratings depends on the robustness of ESG rating methodologies."[24]

Because NRSROs have a lock on ESG products, they will benefit most from consolidation and pseudo-professionalism of ESG analytics providers.[25] NRSROs will also use their ESG lock marginalize objective but uncomfortable ESG analyses, such as the financial sustainability scale. Accordingly, regulators must not "encourage industry participants to develop and follow common industry standards or codes of conduct." Similarly, as IOSCO endorses and perpetuates the NRSRO conflict of interest, it must step away from "supporting the development of such standards or codes, regarding: the identification, management and mitigation of conflicts of interest for ESG ratings and data products providers."

Regarding Recommendation 2, IOSCO should focus solely on the *reliability* of ESG ratings and data products

Specious *comparability* must not be imposed on ESG analysis, ratings, or data products.[26]

Each ESG analytics provider should be free to define ESG analysis, ratings, and data products, as well as the associated development processes, as it sees fit. ("For ESG ratings and data products providers, IOSCO has received feedback that there is scope for guidance to improve the reliability, comparability, and interpretability of ESG ratings and data products."[27])

The industry is too young for the codification of "comparability, and interpretability of ESG ratings and data products."

Again, NRSRO processes are instructive because the petrified NRSRO sector *does* codify "rating and data product terminology."[28] NRSROs also tout "transparency around methodologies for their ESG ratings and data products that are rigorous, systematic, applied continuously." However, the codification and transparency mantras serve only to *destroy* the "reliability, comparability, and interpretability" of NRSRO credit ratings. Almost no end users of NRSRO credit ratings can articulate what any given NRSRO terminology means. Fewer still can *compare and*

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[24] Ibid., page 38.

[25] Ibid., page 12, "Table 2: Examples of recent mergers and acquisitions in the ESG ratings and data provision market."

[26] Ibid., page 41. "**Recommendation 2**: ESG ratings and data products providers could consider issuing high quality ESG ratings and data products based on publicly disclosed data sources where possible and other information sources where necessary, using transparent and defined methodologies."

[27] "Ibid, page 41. Unless otherwise noted, all quotes are from Recommendation 2, pages 41-42.

[28] Ibid, Recommendation 1, page 41.

interpret the range of credit rating announcements and publications that NRSROs post. And not even the most craven NRSRO cronies attest to the *reliability* of NRSRO credit ratings or rank order all NRSRO credit rating methodology for a given sector.

As examples, please poll debt investors on the similarities and differences between credit ratings from Fitch Ratings, Moody's Investors Service, and S&P Global Ratings. Poll debt investors on the respective meanings of announcements in change of rating, rating outlook, and sector outlook for each of the three NRSROs. Poll investors on the link between a credit rating from Fitch, Moody's, or S&P and its use of ESG analytics from corporate affiliates that produce ESG analytics.[29] Poll debt investors on the analytical rigor of all NRSRO credit rating methodologies for a given sector. Finally, search the world for a debt investor who attests to the robustness and reliability of credit ratings themselves (general observations of, to paraphrase, "the central role of NRSROs in the economy and the necessity that the companies produce accurate credit ratings" don't count.)

Neither NRSROs nor IOSCO members have any standing to ensure that ESG analytics staff "are professional, competent, and of high integrity." My self-financed, entirely public-domain advocacy to rid global structured finance of the flip clause attests to the laziness, cowering, and entirely self-interested attributes that define NRSRO staff from top to bottom.[30]

Regarding Recommendation 3: Stop Asking for the Impossible and the Implausible

IOSCO and G20 ask for the impossible in seeking ESG ratings and data products that "are, independent and free from political or economic pressures . . ." [31] Because IOSCO, the G20, and

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[29] Ibid., page 12, "Table 2: Examples of recent mergers and acquisitions in the ESG ratings and data provision market."

[30] Harrington, William J. "Electronic Letter to CFTC, SEC, LSTA, SFA, DBRS, Fitch, Moody's and S&P 'Re Deficient Accounting, Capitalization, Credit Ratings, and Regulation of EVERY Party to a Swap Contract with a Flip Clause or Other Walk-Away Provision'," December 28, 2020. (20201228 Harrington J William Flip Clause Questions to CFTC-SEC-LSTA-SFA-DBRS-Fitch-Moodys-S&P.pdf (wikirating.org). As of the date of this submission, I distributed the letter to 187 practitioners, none of whom responded. The 187 practitioners include: 24 regulators (including 13 SEC staff); 58 NRSRO analysts and managers (including 50 former Moody's Investors Service colleagues who can each attest to the impeccable quality of my 22-year, fulltime work on the flip clause); and 24 academicians who focus on the financial crisis but who do not address the flip clause (including now SEC Commissioner Hester Peirce.)

[31] Ibid., page 42. **"**Recommendation 3. "ESG ratings and data products providers could consider ensuring their decisions are, to the best of their knowledge, independent and free from political or economic pressures and from conflicts of interest arising due to the ESG ratings and data products providers' organizational structure, business or financial activities, or the financial interests of the ESG ratings and ESG data products providers' employees." Unless noted otherwise, all quotes are from Recommendations 3-4, pages 42-43.

national governments are the most political of political entities, an IOSCO recommendation by itself is rife with political pressures. Likewise, the political pressure of the U.S. government, largely expressed via the SEC, saddles the whole country with the destructive NRSRO scheme.

"A fish rots from the head down!"[32]

The same political pressures cause IOSCO to harp on the implausible in positing "the financial interests of the ESG ratings and ESG data products providers' employees" as a fundamental conflict of interest. I called-out the canard of NRSRO *staff* conflict of interest ten years ago.[33]

NRSROs demonstrate that the relentless push by ultimate corporate owners such as a holding company to maximize earnings across all franchises, and not the impetus of individual staff to keep their jobs, is the primary conflict of interest that strips credit ratings of credit rating information. IOSCO members continually undermine their pet canard by routinely hiring former NRSRO staff.

To the extent that NRSRO staff from top to bottom are lazy, cowering, and entirely self-interested, it is because the ultimate corporate owners of each NRSRO seek out and reward staff who are lazy, cowering, and entirely self-interested. In short: Staff conflict-of-interest is not a base conflict of interest but rather one if its expressions. The base conflict of interest resides with the ultimate owner. IOSCO and members must stop conflating symptoms with root causes.

NRSROs are not merely instructive on the primary conflict of interest that threatens analytical integrity at ESG analytics providers, but a cautionary tale of the real and present threat that looms over the ESG analytical sector, namely take-overs by NRSRO corporate owners. The take-overs have already undermined ESG analysis and data products, perhaps fatally.[34]

Regarding Recommendation 4, IOSCO misses the big point: Owning an NRSRO, and possibly an ESG rater or data provider, is itself the conflict of interest

As with the NRSRO scheme, the IOSCO recommendation ignores the fundamental conflict of interest in all analytical sectors — namely, the unrelenting push by the ultimate owner to maximize franchise earnings. In misdiagnosing the problem, the IOSCO also buries useful solutions such as controls on ultimate owners and prospective reviews of analytical content.[35]

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32 The Idioms, https://www.theidioms.com/fish-rots-from-the-head-down/, accessed September 3, 2021.

33 Neumann, Jeanette, "Credit Raters Join the Rated", *Wall Street Journal*, December 2, 2011.

34 Ibid., page 12, "Table 2: Examples of recent mergers and acquisitions in the ESG ratings and data provision market."

35 Ibid., page 42. "**Recommendation 4**. ESG ratings and data products providers could consider, on a best-efforts basis, avoiding activities, procedures or relationships that may compromise or appear to compromise the independence and objectivity of the ESG rating and ESG data products provider's

IOSCO and members must first address the fundamental conflict of interest that resides with the ultimate owner of an analytical firm before addressing the tertiary conflicts of interest that staff pose.[36]

Even where the IOSCO Proposal cites corporate conflict of interest it focuses on conflict of interest between affiliates, not across all affiliates.[37] A holding company can, but does not, manage inter-affiliate conflict of interest in many ways, for instance by compensating employees *across* affiliates on the robust performance of *all* products by *all* affiliates. If NRSRO and ESG ratings are essentially utilities, IOSCO should propose that NRSRO credit rating analysts, ESG rating analysts, and other ESG data staff be compensated like public servants.

If an ESG analytics provider mitigates the fundamental conflict of interest that would otherwise compromise products, there is no reason for the provider to combat chimeras, i.e., avoid "activities, procedures or relationships that may . . . appear to compromise the independence and objectivity of the ESG rating and ESG data products provider's operations."

Regarding Recommendation 5, It's reasonable but does not require regulation[38]

Recommendation 5 undercuts IOSCO suggestions that ESG analytics providers codify offerings by synching them with each other rather than with what various ESG practitioners around the world require.[39]

Also, an important caveat. "[H]igh levels of public disclosure and transparency" do not guarantee analytical usefulness and robustness. ESG practitioners themselves must access the disclosures, fully comprehend them, and continually challenge providers to do better. NRSROs demonstrate how to deploy "transparency" as a cover to dilute content. In my experience, the NRSRO designation discourages even highly knowledgeable, third parties such as equity analysts from digging into and challenging NRSRO credit methodologies for their respective sectors.

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operations or identifying, managing and mitigating the activities that may lead to those compromises." Unless noted otherwise, all quotes are from Recommendations 3-4, pages 42-43.

36 Ibid., page 43. ". . . not compensating or evaluating staff on the basis of the amount of revenue that an ESG rating and data products provider derives from a company that staff provides ESG ratings and data products for, or with which staff regularly interacts regarding such ESG ratings and data products."

37 Ibid., page 38. **"**Most respondents suggested that there should be procedures in place at the level of the provider to separate the staff responsible for ESG ratings and data products from the staff providing consulting services."

38 Ibid., page 43. "**Recommendation 5**. ESG ratings and data products providers could consider making high levels of public disclosure and transparency an objective in their ESG ratings and data products, including their methodologies and processes."

39 Ibid., page 43. ". . . ensuring their ESG ratings and data products are clearly labelled to enable the user to understand the ESG rating's or ESG data product's intended purpose including its measurement objective."

Recommendation 6 is the polar opposite of "transparency" and best-practice governance

IOSCO proposes that ESG analytics providers favor entities being assessed at the expense of end-users.[40]

The recommendation exacerbates the fundamental conflict of interest — namely, the unrelenting push by the ultimate owner to maximize franchise earnings. The simple existence of "confidentiality arrangements with the company" being assessed for ESG performance taints the assessment. How can the ESG analytics provider vet the non-public information that the company in question provides? How can end users vet the ESG analytics?[41]

Regarding Recommendation 7, *Of Course* Users of Analytics Should Due Diligence Them

Financial practitioners should do the jobs they are paid to do. That IOSCO and member must prod financial practitioners to practice mediocre governance, i.e., conduct basic due diligence, demonstrates the extent to financial practitioners shirk basic responsibilities.[42]

Users of ESG analytics must conduct "due diligence on the ESG ratings and data products that they use in their internal processes." Likewise, users of NRSRO credit ratings must conduct "due diligence on the . . . ratings and data products that they use in their internal processes."

Users of ESG analytics must evaluate "the published methodologies of any ESG ratings or data products that they refer to in their internal processes." Likewise, users of NRSRO credit ratings must evaluate "the published methodologies of any . . . ratings or data products that they refer to in their internal processes."

The NRSRO and similar IOSCO-blessed schemes encourage just the opposite of IOSCO goals for ESG analytics providers. Users of NRSRO credit ratings neither conduct due diligence on credit ratings nor evaluate credit rating methodologies. The twin failures of users of NRSRO credit ratings to practice even mediocre governance, let alone best-practice governance, should

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40 Ibid., page 44. "**Recommendation 6**. ESG ratings and data products providers could consider maintaining in confidence all non-public information communicated to them by any company, or its agents, related to their ESG ratings and data products, in a manner appropriate in the circumstances." Unless noted otherwise, all quotes are from Recommendation 6, page 44.

41 Ibid., ". . . using non-public information only for purposes related to their ESG ratings and data products or otherwise in accordance with their confidentiality arrangements with the company."

42 Ibid., page 44. "**Recommendation 7.** Financial market participants could consider conducting due diligence on the ESG ratings and data products that they use in their internal processes. This due diligence could include an understanding of what is being rated or assessed by the product, how it is being rated or assessed and, limitations and the purposes for which the product is being used."

convince IOSCO to let each ESG ratings or analytics provider determine its own best-practices regarding process and content.

Recommendations 8 & 9 are Assessed Entities Whining

A company that invites ESG scrutiny has myriad best-practice ways to communicate directly with stakeholders and does not need IOSCO-endorsed, secret channels in which it and an ESG analytics provider massage public output.[43]

The more directly and clearly an entity communicates with stakeholders, the better the governance and the less pertinent are third-party evaluations. ESG practice is intended to boost social and natural systems. ESG assessment must serve that end, not be an end in itself.

Recommendation 9 is the opposite of transparent and above-board and recalls the crisis-causing procedures at NRSROs pre-2008. Many of the proposed steps indicate a problem with either the ESG analytics provider or the assessed entity being assessed. End-users of ESG analytics should know as much as possible of the whole dialogue between evaluated entity and evaluator, particularly if a dispute arises.[44]

"It should be noted that there is a potential risk of conflicts of interest in the interaction between ESG ratings and data products and providers."[45]

Regarding Recommendation 10: Yes, Assessed Entities Should Stop Whining and Start Doing Better

Assessed entities should not need IOSCO prodding to implement best-practice governance by communicating openly and transparently for the benefit of all constituents.[46]

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43 Ibid., page 45. **"Recommendation 8:** "ESG ratings and data products providers could consider improving information gathering processes with entities covered by their products in a manner that is efficient and leads to more effective outcomes for both the providers and these entities." II **Recommendation 9:** "ESG ratings and data products providers could consider responding to and addressing issues flagged by entities covered by their ESG ratings and data products while maintaining the objectivity of these products."

44 Ibid., page 45. **Recommendation 9 (cont.)**:
"providing a clear and consistent contact point with whom the covered entity can interact to address any queries relating to the assessment provided by the ESG ratings and data products provider.
"informing covered entities of the principal grounds on which an ESG rating or ESG data product is based before the publication of the ESG rating or data product.
"allowing the covered entity time to draw attention to any factual errors in the product, including the data and information underlying the product."

45 Ibid., page 39.

46 Ibid., page 46. "**Recommendation 10**: Entities subject to assessment by ESG ratings and data products providers could consider streamlining their disclosure processes for sustainability related information to the extent possible, bearing in mind regulatory and other legal requirements in their jurisdictions."

Sincerely,

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Mr. Gregg Lemos-Stein, S&P Global Ratings
Mr. Thomas Torgerson, DBRS Morningstar
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