Moody's

Moody's Shared Services UK Ltd
One Canada Square
Canary Wharf
London E14 5FA
+44 20 7772 1000 tel
moodys.com

15 July 2020

By Electronic Submission

MOODY'S ESG SOLUTIONS GROUP RESPONSE TO EUROPEAN COMMISSION CONSULTATION ON THE RENEWED SUSTAINABLE FINANCE STRATEGY

Moody's ESG Solutions Group and Moody's majority-owned affiliates Vigeo Eiris and Four Twenty Seven appreciate the opportunity to provide comments to the European Commission in response to its Consultation on the Renewed Sustainable Finance Strategy.

Moody's ESG Solutions Group is a business unit of Moody's Corporation. In conjunction with its affiliates, Moody's ESG Solutions Group provides ESG and climate risk solutions including ESG scores, analytics and Sustainable Finance Reviewer/certifier services. Vigeo Eiris is a global leader in ESG assessments, data, research, benchmarks and analytics. Four Twenty Seven is a leading provider of data, intelligence and analysis related to physical climate risks.

We have observed fast growing investor interest in ESG considerations. For example, while ESG investment was long seen as a niche activity, Vigeo Eiris now experiences increasing demand for its products and services from "mainstream" investors; as well as growing international demand. We believe this is evidence of a significant, and potentially permanent, shift in investor attitudes.

We have three overarching observations on the Commission's Renewed Sustainable Finance Strategy:

1. The sustainable finance market is best served by continued efforts to improve the comparability, consistency and quality of ESG-relevant data, information and issuer disclosures.
2. Different ESG risk assessment tools deserve different policy consideration.
3. ESG assessment providers do not require regulation.

1. The sustainable finance market is best served by continued efforts to improve the comparability, consistency and quality of ESG-relevant data, information and issuer disclosures

We support ongoing policy efforts to improve the comparability, consistency and quality of ESG-relevant data, information and issuer disclosures.

Greater harmonisation in the metrics for measuring ESG will help to establish a clearer framework for the discussion of ESG considerations by market participants and other stakeholders and will provide a clearer starting point on which ESG assessment companies can base their analysis and research. While still allowing for a full range of views, it will be easier for ESG assessment companies to obtain the data necessary for their work and to demonstrate the coherence and comparability of their analysis. Investors, in turn, will benefit from greater confidence in ESG-relevant data and from the additional clarity around ESG assessments. This should also facilitate their choice of ESG assessment provider.

In this context, we welcome the Commission's efforts to improve issuer disclosures under the Non-Financial Reporting Directive. We would also welcome a single data portal for companies' ESG-relevant information.

We further support efforts to increase the availability of data related to physical climate risks. For example, consistent tracking of climate-related losses both for government assets and for corporate and financial entities can help increase awareness of the potential impacts of climate change and to inform and improve preparedness efforts.

2. Different ESG risk assessment tools deserve different policy consideration

We share the view expressed by our affiliate, Moody's Investors Service (MIS) that the three tools of (i) ESG assessments, (ii) Green Bond verification, and (iii) credit ratings are inherently different and should not be treated under one policy framework. While these tools can be complementary, they each perform discrete roles that support the differing needs of market practitioners:

- ESG and sustainability assessments measure the extent to which an issuer integrates, manages and discloses key sustainability factors in its activities. Each provider may have a different philosophy and approach in respect of precisely what it is that their products are seeking to measure and how to evaluate trade-offs between the needs of different stakeholders.

- External verifiers assess an issuer's or financial instrument's credentials in respect of an external standard, such as the Green Bond Standard. Verification is typically binary, i.e. the verifier concludes that the standard is either met or it is not met. This is as opposed to locating an issuer or instrument on a scale of performance, as is generally the case for ESG assessments.

- Credit ratings speak to the relative credit risk of rated issuers or financial obligations, i.e. the issuer's ability and willingness to repay its contractual financial obligations as they come due. They do not seek to measure a company's impact on society or the environment but take account of ESG considerations where relevant to credit analysis.

These tools fulfil different roles in the market, should not be confused with each other, and each deserve separate policy consideration.

3. ESG assessment providers do not require regulation

a. The market is young and will benefit from providers' competition for thought leadership

There is currently a diverse range of ESG research and assessments providers. This diversity yields different approaches on what to measure, different methodologies, different strengths, and different insights. Diversity promotes healthy debate at this early stage of the market's development.

At the heart of many of the differences between ESG assessment providers lies the question of "*what are you trying to measure*?". Broadly, there are three responses to this question:

- **Dual materiality approach.** Assessments speak to both the impacts of ESG factors on the company as well the impacts of the company on its stakeholders. This is the case for Vigeo Eiris.

- **Single/ financial materiality approach.** The assessment focuses purely on the capacity of the company to manage ESG factors that may impact its financial and operational performance.

- **Issue-specific.** The assessment speaks to an individual factor, such as climate, or human rights, or animal welfare.

Additional diversity across ESG assessment providers results from different points of view as to how well a company manages trade-offs between the needs and expectations of different stakeholders, including communities, customers, employees, creditors and shareholders. Different providers also utilise different data collection methods and different metrics to measure impact.

In our experience, there is market demand for a range of different approaches and investors value different views and philosophies. There is no one "correct" answer as to what ESG should seek to measure. Investors need to decide which approach best suits their own investment philosophy. ESG assessment providers, in turn, are competing for thought leadership and the most credible, consistent and comparable offering.

b. There is no market failure in respect of ESG assessments

The Commission's consultation questions appear to imply a belief that the market in its current structure is fundamentally dysfunctional and that ESG assessments lack rigour and consistency.

In our experience, this is not an accurate conclusion for the industry as a whole.

By its nature, diversity of approaches leads to diversity of conclusions for individual issuers. This does not necessarily mean that the underlying assessments are flawed. Assessments should be coherent across a single provider's offerings. There should not be an expectation of comparability across different providers for ESG assessments. Importantly, this is one of the differences with Green Bond verification where all providers assess companies against the same standard.

Instead, functioning of the market for ESG assessments should be measured against the question as to whether the offering adequately caters to the range of evolving investor needs.

Vigeo Eiris seeks to do that by providing ESG assessments that display the following characteristics:

- Standards-based: we build our assessment framework from international norms and reference standards including, for example, the United Nations, the OECD, and the Global Reporting Initiative.
- Consistent: the core of our ESG assessment methodology has remained stable since its conception in 2002.
- Transparent: we provide in-depth descriptions of our methodologies to investors and provide issuers with full access to their assessments.
- Up to date: we keep track of circumstances and regularly update our assessments.
- Holistic: our model systematically examines three core concepts: (i) the company's policies on a given issue, (ii) the means reported, and (iii) the observed results. This consistent approach allows for easy understanding and breakdown of the meaning of our scores.
- Insightful: by applying sector specific models and combining our issuer research with sector reports and benchmarks, we provide the market with a detailed overview on the issuers as well as a contextual view in light of their peers.

We have observed that investors are becoming increasingly sophisticated in using our assessments, for example by building the individual categories (E, S or G) and the underlying data points into their processes so as to best align our research with their own in-house views. We also provide a portfolio management solution where clients can create their own scores and portfolio assessments on demand.

c. There is a risk of over-regulation which would disincentivise green and sustainable issuance

We share the Commission's level of concern and sense of urgency about the ecological and climate crisis. We are concerned that related risks are still underappreciated. We welcome the Commission's focus on the European Green Deal and its according efforts to ensure that the financial system aligns with the Commission's climate and sustainability targets.

We are, however, concerned that a regulatory approach that imposes further regulation on "green" and "sustainable" investments may inadvertently disincentivise such issuance, rather than greening the entire market and economy.

Under the Commission's first sustainable finance strategy, the Commission has already created important new tools that will fundamentally change the structure of the sustainability market. This includes, in particular, the Taxonomy of sustainable economic activities which provides a defined standard in respect of "E" criteria. A third party verification regime would be a logical complement to the EU Green Bond Standard that is being developed in conjunction with the Taxonomy.

In parallel to the Taxonomy, there are a wide range of possible answers to the question as to what constitutes relevant ESG metrics and socially acceptable or preferable business practices. These answers are subject to evolution over time and benefit from debate and diversity of views. Investors should be free to adopt their own approaches as to what kind of economic activities they would like to finance.

Providers of ESG data and assessments can make an important contribution to this debate and can act as a catalyst by seeking to serve investor demand. ESG assessments should be allowed and encouraged to co-exist with the Taxonomy and to provide alternative views that may go broader or narrower than the Taxonomy.

The market for ESG assessments is still immature and developing rapidly. Introducing a regulatory framework at this stage would risk stifling innovation and imposing a solution on the market that might not be best suited to investor preferences.

We thank you for your consideration and would appreciate the opportunity of a follow up discussion.

Yours sincerely,

/S/ Andrea Blackman

Andrea Blackman
Managing Director – Global Head of Environmental, Social, Governance and Climate