

**The international business of Federated Hermes and EOS at Federated Hermes –
Response to the IOSCO consultation on ESG ratings and data providers
[Due September 6, 2021]**

Introduction to the international business of Federated Hermes and EOS at Federated Hermes

The international business of Federated Hermes – a majority owned subsidiary of Federated Hermes Inc. – is a global leader in active, responsible investment¹. The international business of Federated Hermes (‘Federated Hermes’) includes Hermes Investment Management Limited (HIML) and EOS at Federated Hermes (‘EOS’). HIML is authorised and regulated and carries out regulated activities referred to. EOS is a stewardship services provider and does not carry out regulated activity.

We are guided by the conviction that responsible investing is the best way to create long-term, sustainable wealth. We provide specialized capabilities across equity, fixed income and private markets, in addition to multi-asset strategies and proven liquidity-management solutions. Through our world-leading stewardship services, we engage companies on strategic and sustainability concerns to promote investors’ long-term performance and fiduciary interests. Our goals are to help individuals invest and retire better, to help clients achieve better risk adjusted returns, and where possible, to contribute to positive outcomes in the wider world. As of June 30, 2021, Federated Hermes had \$645.6 billion assets under management.

EOS is a leading stewardship provider. Our engagement activities enable long-term institutional investors to be more active owners of their assets, through dialogue with companies on environmental, social and governance issues. We believe this is essential to build a global financial system that delivers improved long-term returns for investors, as well as better, more sustainable outcomes for society. EOS represents \$1.75 trillion of assets under advice as of June 30, 2021. EOS conducts proactive and reactive engagement with the companies in which its clients invest on a regular basis on environmental, social, governance, strategy, risk and communications concerns. Our team engages in active stewardship on behalf of clients, making voting recommendations at annual meetings and other shareholder gatherings to achieve our clients’ responsible ownership aims and fulfil their fiduciary duty to be active owners.

Overview

We welcome the opportunity to provide feedback to the Board of the International Organization of Securities Commissions (IOSCO) on its proposed [recommendations](#) regarding environmental, social and governance ratings and data providers set out in the consultation report dated July 2021.

¹ Hermes Investment Management and Federated Investors rebranded as Federated Hermes in February 2020. All activities previously carried out by Hermes Investment Management now form the international business of Federated Hermes.

We note also the focus by ratings agents and data providers by the FCA in its recent consultation on enhancing climate-related disclosures by standard listed companies and seeking views on ESG topics in capital markets.

Our responses to the recommendations are provided as follows.

Response to consultation proposed recommendations

Proposed Recommendations for IOSCO and IOSCO Members concerning ESG ratings and data products

Where regulators have supervisory authority over ESG ratings and data products providers, they may wish to consider whether the reliability, comparability and interpretability of ESG ratings and data products could be enhanced by taking steps to improve the governance and transparency of the assessment process and the management of conflicts of interest. Taking steps to improve the governance, transparency and management of conflicts of interest surrounding these products could in turn contribute to a greater level of confidence in the use of these products within the financial system, supporting a greater up-take in usage while simultaneously protecting investors and ensuring that markets are fair and efficient, in line with IOSCO objectives.

Where regulators have supervisory authority over Credit Rating Agencies (CRAs) that also issue ESG ratings and data products, they may wish to consider the extent to which the processes for determining ESG ratings and data products overlap with the processes for determining credit ratings. They may wish to consider whether there exists the potential for conflicts of interest between a CRA's credit rating offerings and its ESG ratings or data product offerings, and if so, the steps to consider to mitigate and address those conflicts of interest.

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.

Please provide your views on the following action points related to this proposed recommendation. For example, would the action points outlined below help enable securities regulators to meet the objectives of this proposed recommendation? If so, how? Are there other action steps regulators may wish to consider?

1. Regulators may wish to consider their existing regulatory regimes and consider whether they provide sufficient oversight of ESG ratings and data products.
2. Where regulators have supervisory authority over ESG ratings and data products providers, they may wish to consider:
 - a. Potential conflicts of interest that may occur with ESG ratings and data product offerings and other business relationships with the covered entities such as provision of second party opinions for green finance products and ESG consulting services, and whether the corporate governance organisational and operational structures of the provider are sufficient to identify, manage and mitigate any conflicts of interest?
 - b. Whether the data and information sources that the provider relies on are publicly disclosed, including the use of industry averages, estimations or other methodologies when actual data is not available or not publicly disclosed?
 - c. Whether the provider's methodologies are publicly disclosed, including whether and how the methodologies are defining the individual components

- Environmental, Social, Governance of “ESG”, including the specific issues being assessed, the KPIs used and measurement methodologies underlying each KPI?
- d. Whether the provider’s ESG ratings and data products are issued consistent with the relevant methodologies?
 - e. Whether the processes underlying ESG ratings and 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?

3. Regulators may wish to consider whether there are opportunities to encourage industry participants to develop and follow common industry standards or codes of conduct, and what role IOSCO could play in supporting the development of such standards or codes, regarding:
 - a. the identification, management and mitigation of conflicts of interest for ESG ratings and data products providers;
 - b. consistency and transparency of ESG ratings and data product methodologies; and/or
 - c. the use of sustainability related and ESG rating and data product terminology to help improve consistency in the use of these terms in the ESG rating and data products providers’ industry.

Agree. We welcome more attention by regulators on the use of ESG ratings and data products as envisaged by the activities outlined. The rate of change in ESG ratings and data products, coupled with increased digitisation, may present challenges and regulators would need to be able to keep pace with these changes for this focus to be effective. Clarification of expectations relating specifically to the use of ESG ratings providers would be useful for the industry. Global co-ordination of such efforts would create a coherent set of expectations for ESG ratings and data providers across jurisdictions.

We agree with the focus on transparency and management of conflicts of interest for any voluntary code or regulatory intervention. As investors we are not seeking standardisation of outputs as ultimately ESG ratings are an opinion, and there is value in the divergence of scores. What is important, however, is that the methodologies and the measurement objective are clear, and that the providers have the appropriate due diligence processes in place to ensure they are using reliable sources of information, interpreting it correctly and removing controversies that are no longer relevant. They should be transparent about the sources of their data, the methods used to estimate where there are data gaps and the frequency with which data inputs are updated.

We also agree that regulators could seek an opportunity to encourage industry participants to develop and follow common industry standards, principles, or codes of conduct to enhance reliability, comparability and interpretability.

In the development of a code and or regulatory oversight, we also believe consideration could be given, with perhaps a lower level of scrutiny/oversight, to NGO led rankings/ratings to ensure transparency, independence and good governance are in place for this cohort.

Proposed Recommendations for ESG ratings and data products providers

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. To help address the issues that have been raised, IOSCO has proposed recommendations regarding transparency and consistency in the application of the rating and assessment process, the identification, management, and mitigation of conflicts of interest, transparency of data sources, and disclosures and handling of confidential information. The goal here is to propose high level guidance for ESG ratings and data products providers that is sufficiently flexible to accommodate the developing nature of this market.

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.

ESG ratings and data products providers may wish to consider:

- a) adopting and implementing written procedures designed to ensure that the ESG ratings and data products they issue are based on a fair and thorough analysis of all relevant information available to them.
- b) adopting, implementing and providing transparency around methodologies for their ESG ratings and data products that are rigorous, systematic, applied continuously and, for ESG ratings, subject to some form of validation based on historical experience, where available.
- c) ensuring these methodologies are subject to regular review, with sufficient communication regarding changes made to the methodologies as well as potential impacts of these changes to the ESG ratings and data products.
- d) providing transparency around the sources of data used in determining their ESG ratings and data products, including the use of any industry averages, estimations or other methodologies when actual data is not available. This may include transparency around whether the data used is up to date, publicly sourced or proprietary in nature, including through approximations.
- e) monitoring on an ongoing basis, and regularly updating, their ESG ratings and data products.
- f) maintaining internal records to support their ESG ratings and data products.
- g) sufficient resources to carry out high-quality ESG-related assessments, including sufficient personnel and technological capabilities, to seek out information they need in order to make an assessment, and analyse all the information relevant to their decision-making processes.
- h) how to ensure personnel involved in the deliberation of ESG ratings and data products are professional, competent, and of high integrity.

Agree.

We are supportive of written procedures or a voluntary code. We appreciate that each ratings and data provider will have their own methodologies based on their focus of interest and this is not in itself a problem. The key is that this methodology is transparent, including how data is aggregated and weighted to produce the overall rating.

Transparency, governance, and management of conflicts of interest are the appropriate focus either for a voluntary code or regulatory intervention. Ratings providers for example – particularly given they follow an ‘investor pays’ model – will not have access to perfect data, and it will not be feasible to hold them to account for this. What is important, however, is that they have the appropriate due diligence processes in place to ensure they are using reliable sources of information, interpreting it correctly and removing controversies that are no longer relevant. They should be transparent about the sources of their data and the methods used to estimate where there are data gaps.

In the end, investors and other financial market participants, including companies seek high quality, comparable and consistent information from ESG ratings agencies and data providers that is decision-useful enabling the assessment of a company’s past and future performance relative to its peers and industry.

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.

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 operations or identifying, managing and mitigating the activities that may lead to those compromises.

Please provide your views on the following action points related to these proposed recommendations. Would the action points outlined below help enable ESG rating and data products providers to meet the objectives of these proposed recommendations? If so, how? Are there other action steps ESG rating and data products providers could consider?

ESG ratings and data products providers may wish to consider

1. adopting written internal procedures and mechanisms to (1) identify, and (2) eliminate, or manage, mitigate and disclose, as appropriate, any actual or potential conflicts of interest related to their ESG ratings or data products that may influence the opinions and analyses ESG ratings and data products providers make or the judgment and analyses of the individuals they employ who have an influence on their ESG ratings or data product decisions. ESG ratings and data products providers should aim to disclose such conflict avoidance and management measures.
2. taking steps to ensure the ESG ratings and data products would not be affected by the existence of or potential for a business relationship between the ESG ratings and data products providers (or their affiliates) and any company or any other party for which it provides ESG ratings or data products.
3. putting in place measures to ensure their staff members refrain from any securities or derivatives trading presenting inherent conflicts of interest with the ESG ratings and data products.
4. structuring reporting lines for their staff and their compensation arrangements to eliminate or effectively manage actual and potential conflicts of interest related to their ESG ratings and data products.
5. 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.
6. disclosing the nature of the compensation arrangement or any other business or financial relationships that exist with a company for which the ESG ratings and data products provider provides ESG ratings or data products.

Agree. We support the actions outlined as mechanisms that could assist ESG ratings and data product providers avoid activities, procedures or relationships that may compromise or appear to compromise their independence and objectivity. Certain actions could also be incorporated into procurement terms and supplier agreements between entities.

We expect the ESG ratings and data providers to provide products without political or other types of institutional bias and or economic pressure both in fact and perception. In certain markets where ESG ratings and data product providers operate we recognise there may be circumstances where political and or economic pressure may make the achievement of these actions challenging. Additional actions IOSCO may wish to consider:

- unconscious bias training and education for all ESG ratings and data provider employees
- access for all employees to a whistleblowing hotline
- asking providers to disclose their lobbying and political contributions including trade associations they are a member of.

In relation to the final action (6) recommended, '*disclosing the nature of the compensation arrangement or financial relationships...*' between the provider and its customer or client we appreciate this may risk breaching the commercial terms and conditions between entities. We trust this will be further discussed within IOSCO and with parties.

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.

Please provide your views on the following action points related to this proposed recommendation. Would the action points outlined below help enable ESG rating and data products providers to meet the objectives of this proposed recommendation? If so, how? Are there other action steps ESG rating and data products providers could consider?

1. ESG ratings and data products providers may wish to consider:
 - a. making high levels of public disclosure and transparency an objective in their ESG ratings and data products.
 - b. 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.
 - c. publicly disclosing the data and information sources they rely on in offering ESG ratings and data products, including the use of industry averages, estimations or other methodologies when actual data is not available.
 - d. publishing sufficient information about the procedures and methodologies underlying their ESG ratings and data products to enable the users of these products to understand how their outputs were determined.
2. Information regarding methodologies that ESG ratings and data products providers may wish to consider publishing include, but is not limited to:
 - a. the measurement objective of the ESG rating or data product;
 - b. the criteria used to assess the entity or company;
 - c. the key performance indicators used to assess the entity against each criterion
 - d. the relative weighting of these criteria to that assessment;
 - e. the scope of business activities and group entities included in the assessment;
 - f. the principal sources of qualitative and quantitative information used in the assessment as well as information on how the absence of information was treated;

- g. the time horizon of the assessment; and
- h. the meaning of each assessment category (where applicable)

Agree with no further comments

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.

Please provide your views on the following action points related to this proposed recommendation. Would the action points outlined below help enable ESG rating and data products providers to meet the objectives of this proposed recommendation? If so, how? Are there other action steps ESG rating and data products providers could consider?

ESG ratings and data products providers could consider:

1. adopting procedures and mechanisms related to their ESG ratings and data products to protect the non-public nature of information shared with them by companies under the terms of a confidentiality agreement or otherwise under a mutual understanding that the information is shared confidentially.
2. 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

Agree with no further comments

Proposed Recommendation for users of ESG ratings and data products

For the users and uses of ESG ratings and data products, IOSCO has been able to draw on the process of its fact-finding exercise. The fact-finding exercise showed that ESG ratings and data products may underpin many ESG indices, and screening criteria for certain ESG-oriented products. IOSCO has identified that it would be beneficial to propose recommendations that promote the adoption of procedures for the conduct of due diligence and governance to ensure mechanistic reliance on ESG ratings and data products is avoided where at all possible.

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.

Please provide your views on the following action points related to this proposed recommendation. Would the action points outlined below further the objectives of this proposed recommendation? If so, how? Are there other action steps financial market participants could consider?

Financial market participants may wish to consider evaluating the published methodologies of any ESG ratings or data products that they refer to in their internal processes. This evaluation could cover:

1. the sources of information used in the product, the timeliness of this information, whether any gaps in information are filled using estimates, and if so, the methods used for arriving at these estimates;
2. An evaluation of the criteria utilised in the ESG assessment process, the relative weighting of these criteria in the process, the extent of qualitative judgement and whether the covered entity was involved in the assessment process; and
3. a determination as to the internal processes of the financial market participant for which the product is suitable.

Agree. We ourselves (and expect other financial market participants to) conduct the necessary due diligence including evaluation of published methodologies of ESG ratings and data product providers prior to subscribing to their services as a matter of good procurement and business practices. We appreciate however that the standards and approach to which this due diligence is conducted varies per participant. The actions IOSCO has listed provide a useful guide and may further assist with the harmonisation of requirements for rating and data product providers.

Additional areas the IOSCO may wish to consider include the following and we have been mindful of the burden and potential cost of this recommendation for both participants and ratings and data product providers:

- provider’s human capital management policies and performance regarding talent attraction and retention of ESG experience and expertise
- Transparency on assumptions used in the product
- Certifications and or additional assurance, including systems testing.

Proposed Recommendation on how ESG ratings and data products providers may wish to consider interacting with entities subject to assessment.

For the entities covered by ESG ratings and data products, IOSCO has drawn on feedback received during the fact-finding exercise to propose recommendations these providers could consider to help address some of the reported shortcomings in market conduct.

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.

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.

Please provide your views on the following action points related to this proposed recommendation. Would the action points outlined below help enable ESG rating and data providers to meet the objectives of this proposed recommendation? If so, how? Are there other action steps ESG rating and data products providers could consider?

1. Where they collect information from covered entities on a bilateral basis, ESG ratings and data products providers may wish to consider:
 - a. communicating sufficiently in advance when they expect to request this information regarding their ESG ratings and data products.

- b. including in their requests, pre-inputted information either from publicly available sources or from the covered entities previous submissions, where possible, for the covered entities' review or confirmation.
- 2. ESG ratings and data products providers may wish to consider:
 - a. 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.
 - b. 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.
 - c. allowing the covered entity time to draw attention to any factual errors in the product, including the data and information underlying the product.

Agree. We understand that these actions could become burdensome for some companies, especially smaller ones. An additional action could be added to make sure ESG ratings and data providers firstly exhaust all publicly available information and documents to source company information before reaching out to companies with questions about information that is in the public domain.

Proposed Recommendation on how covered entities could consider interacting with ESG ratings and data products providers

The final part of IOSCO's proposed recommendations addresses those entities covered by ESG ratings and data products providers. This element is included with the intention to address the full spectrum of issues relevant to the production of ESG ratings and data products. For the entities covered by these products, IOSCO proposes recommending that they consider disclosing information in a manner that is consistent, predictable, and easy to access. In this regard, some practical steps that could be considered might include ensuring that sustainability information is made public and is consolidated in the minimum number of locations, with maximum visibility over previous and upcoming disclosures. These steps may help provide ESG ratings and data products providers with the information they need to carry out up to date and accurate assessments, which might reduce the burden on covered entities to follow up with providers to discuss any errors or omissions.

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.

Please provide your views on the following action points related to this proposed recommendation. Would the action points outlined below further the objectives of this proposed recommendation? If so, how? Are there other action steps entities subject to assessment by ESG rating and data products providers could consider?

Entities subject to assessment by ESG ratings and data products providers may wish to consider:

1. creating a dedicated section of their website, or a corporate publication, that includes links to, or coordinates for, all the entities' sustainability related publications.

2. including, in the information provided on the dedicated section of their website or corporate publication, the dates of the relevant publications, as well as the timelines for which they are expected to be updated or refreshed.
3. designating a dedicated internal point of contact to address any requests from or queries to ESG ratings and data products providers that provide coverage for that entity.

Agree. In addition to the action points above, we encourage companies to streamline their disclosures according to those environmental and social issues that are considered material. We welcome too the increasing focus by many entities for information in a machine-readable form with improved tagging to promote cohesion and interconnectivity (and transparency) of all disclosures. For example, researchers or investors frequently use hashtag (#) search approach to look for specific ESG information and or other mechanisms such as XBRL. Companies could consider creating tags for their disclosures to enhance searchability functions and connectivity.

We draw IOSCO's attention to research conducted by the US National Bureau of Economic Research which found that companies are shaping their disclosures for a predominantly artificial intelligence (AI) audience of algorithmic traders, robot investment advisors and quantitative analysts. We also note work by the UK Impact Management Project in this area exploring the creation of a global registry of taxonomies to design and align machine-readable formats of existing sustainability standards and frameworks. A common thread emerging from these initiatives is the present lack of a common digital taxonomy for ESG data and the development of tagging requirements. We expect IOSCO to have further discussions on anticipated timelines for taxonomy development and expected demand, including the evolution to AI and cognitive-based reporting as these developments will impact rating and data providers and the streamlining of disclosure processes.