

Input to the German Council on Sustainable Developments' Living document on a H4SF: the crucial role of sustainability rating agencies within the Transformation to Sustainable Finance (September 2017)

In June 2017, the German Council on Sustainable Development published its living document on a Hub for Sustainable Financing (H4SF). It mentions various issues, where information about the sustainability of companies and states is crucial for investors, asset managers, insurers etc. Sustainability rating agencies like oekom research AG do provide this function as their core business and thus can play a crucial role in the transformation of economy towards sustainability by laying the basis for capital allocation decisions. With this document, we would like to give input to the debate with regard to a sustainability rating agencies' role.

The very basis for reallocating capital towards a sustainable, low-carbon economy is sustainability information about potential investment objects such as companies and countries. Without such information no investor or asset manager can integrate the factor of sustainability into its decision-making. Since the first steps that first-movers like oekom research took nearly 25 years ago, this research has seen an ever-rising demand from investors and asset managers, which has led to the recent development of SRI moving into the mainstream.

Sustainability rating thus being a key requirement for Sustainable Finance, the catalytic Hub-process that is needed to achieve the targets mentioned in the Living document has to focus on leveraging the potential that lies within this function. It has to examine business model, conditions, methodology, standards, key players and integration into the finance value chain. The degree to which leveraging the potential of qualitative sustainability rating is achieved will determine the impact of Sustainable Finance.

We see two crucial leverage points for sustainability ratings:

- our research provides a tool to help investors integrate the opportunities and risks presented by sustainable development into their investment decisions. Thus, it enables them to achieve long-term success and to foster the sustainable development of business.
- our ratings give companies an incentive to improve their environmental and social performance continuously.

From oekom research's point of view, there are three key preconditions for the business of sustainability rating in excellence:

A condition „sine qua non“: independence

With respect to sustainability rating, independence means two different things:

- The business model: sustainability rating is done on behalf of the investor (a substantially difference to the one of credit rating agencies which work on behalf of the issuer).
- Additionally, it is crucial that no asset manager or index provider holds shares of a sustainability rating agency.

While the first aspect is valid for nearly all market players, the second only applies to very few. To oekom research both aspects are applicable: we are managerially and economically independent and can thus guarantee a high degree of credibility and objectivity for our research findings. With regard to the experience of the financial crisis, this credibility is a very basic condition for a future sustainable finance market. Companies lacking this independence will hardly be able to fulfil the promise of credible ratings, no matter how much sustainability skills they may develop.

Track record: the proof of competence

In the financial market, decision-makers heavily rely on statistics in their daily business – this is not different with regard to sustainability. The fact that oekom research has nearly 25 years of experience in sustainable investment and sustainability rating makes us a dependable partner for asset managers. Market players like credit rating agencies, which have only recently begun to build up ESG skills, will find it challenging to show a credible long-term-track record even when skills are bought-in.

In-depth analyses: a sign of quality

A mature evaluation of methodology is an essential prerequisite for robust analysis and results that stand up to scrutiny. oekom research's Corporate Ratings are based on a scientifically developed list of criteria and have acquired an outstanding reputation among experts in the field. Our analyses of the environmental, social and governance performance of securities issuers set the standards for a dynamic market.

The provision of financial ratings by credit rating agencies is essential for the finance market. But the target to augment the importance and use of sustainability rating should not merely be achieved by building up sustainability expertise within the credit rating agencies – due to the above mentioned problems regarding independence, track record and in-depth analyses. oekom research supports the identification of crucial points for both actor groups and develop cooperation strategies. We hope that the German Council on Sustainable Development is planning further work on this issue within the H4SF. And therefore, we would like to propose an offer: as a provider of independent high quality ESG-ratings, oekom would be happy to contribute further ideas on how to ideally combine financial and sustainability rating in the further process.

About oekom research:

oekom research is one of the pioneers in sustainability rating. It was founded in 1993 and has over the years grown to a company with 110 employees, more than 6200 issuers in its global universe and branches in Paris, London and New York. It was awarded the ARISTA certification and the Deep Data Delivery Standard in gold.

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