



Submitted via email:

March 11, 2022

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Re: Questionnaire about ESG-related products, ESG ratings providers

Institutional Shareholder Services Inc. (ISS) appreciates the opportunity to respond to questions raised by the Financial Services Agency of Japan (JFSA) regarding ESG-related products and ESG ratings and data product providers.

ISS is a long-standing participant in the corporate governance and responsible investment community in Japan and globally. Having first opened our Tokyo office in 2001, we have been working with Japanese investors to meet their stewardship and governance research needs for more than 20 years. ISS is a leading provider of corporate governance and sustainable investing solutions, market intelligence and fund services, and events and editorial content for institutional investors and corporations. ISS ESG, the responsible investment arm of ISS, provides institutional investors with comprehensive data, analytics and advisory services to help them understand, measure and manage ESG-related risks and opportunities to achieve their investment objectives. ISS' comments represent our views in our capacity as an ESG ratings and data products provider, and as a thought leader in the areas of corporate governance and responsible investment, and not necessarily the views of our clients.

In addition to the enclosed detailed response, ISS would like to highlight our general views on certain issues raised by the JFSA's questions:

- **ISS agrees with the principle that providers need to develop and deliver ESG offerings with a high level of independence, integrity and transparency.** This is consistent with our own abiding commitment to provide institutional investors with independent, high-quality research and products in a consistent and transparent way, and to carry out our duties solely in the best interest of our investor clients. To the extent the JFSA is considering an industry Code of Conduct, we note that ISS already provides its clients with an extensive array of information about how ISS conducts its business. This letter details our robust processes to ensure the quality, independence, transparency, and reliability of our research and products. We appreciate and encourage

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continuing dialogue between the JFSA and the industry for the providers to understand the intended regulatory goals and for JFSA to understand the potential market impact.

In general, we believe principles-based codes of conduct with appropriate minimum standards have the advantage of being flexible enough to accommodate new market developments while encouraging continuous improvement of best practices. Ultimately, it is the investors, as sophisticated consumers of the products, who demand industry discipline.

With respect to transparency of methodologies, we note that disclosure should facilitate clarity while fostering an innovative and competitive marketplace. This is especially relevant given the fast-evolving ESG data market, where competitive differentiation encourages new market entrants, fosters innovation and offers investors the choices they demand.

- **ISS supports the JFSA's aim of ensuring the independence and objectivity of ESG ratings and data products.** We agree that the credibility of ESG ratings and data products is rooted in their accuracy, independence and objectivity, as well as that of the providers. While ISS often interacts during the research process with corporate issuers to ascertain accuracy and completeness of its ESG research offerings, this interaction is voluntary and unique to the current state of ESG corporate data, as explained below. It is critical that regulators safeguard the independence of ESG ratings and data products by maintaining that neither issuers nor any other party is permitted to “police” or interfere with the providers’ policies and procedures or their relationship with their investor clients.
- **Increasingly, ESG information is part and parcel of fundamental investment analysis, rather than supplemental to it.** This shift signals investors’ maturing understanding of ESG factors and the increasing relevance of ESG data to investment decision-making. From a regulatory perspective, ESG data and its providers should therefore be treated on a level playing field relative to “traditional” financial data and its providers. There is no public policy justification for raising unique scrutiny of ESG data and its providers, which would be unprecedented and to the detriment of investors.
- **A regulatory approach that goes beyond principles risks precluding new market entrants and curtailing providers’ ability to keep pace with ESG market developments and satisfy investors’ needs.** ESG data and research providers such as ISS are partners to investors in their quest to understand the complex and changing universe of ESG risks. In this regard, we encourage regulators to be mindful of the potential impact of regulation on the ability of providers to meet investors’ diverse and continually evolving needs.
- **Though diversity of ESG factors is a complexity for ESG ratings comparability, it is a strength for investment analysis.** We understand how limited market consensus around determinative ESG factors and ESG terminology may lead regulators to consider standardizing terminology or delineating use cases for ratings. In our experience, however, investors are not of a single mind with respect to ESG issues nor how they incorporate ESG ratings and data into their investment processes – this diverse ESG “lens” is an asset to financial analysis and capital markets. Public policy should encourage this diversity and avoid cementing a one-size-fits-all approach.
- **More comprehensive and comparable corporate disclosure will enhance market confidence in ESG rating and data products. Effective and timely corporate reporting sets the foundation for ESG ratings and data products.** ISS supports regulatory and international standard setter efforts to promote decision-useful, machine-readable and reliable ESG corporate disclosure. These efforts are critical to closing the gap between current corporate reporting, upon which providers rely, and investor needs, which providers try to meet. Greater corporate disclosure will not only enhance investor understanding of companies’ ESG risks and



opportunities, it will deepen the engagement between investors and issuers and moderate the need for providers to seek alternative data and survey companies to close data gaps.

Finally, we note that the views in this letter are generally consistent with our [response](#) to the International Organization of Securities Commissions (IOSCO) Consultation on ESG Ratings and Data Products Providers.

In closing, we would like to reiterate our appreciation for the opportunity to provide our comments and for your consideration of our views. We would be pleased to respond to any questions or discuss the matter further.

Respectfully,

A handwritten signature in black ink, appearing to read "Max H".

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A handwritten signature in black ink, appearing to read "Bonnie Saynay".

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A handwritten signature in black ink, appearing to read "K. Karakulova".

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ISS ESG Response to the Financial Services Agency, The Japanese Government

ISS' goal is to serve our clients with their full trust and confidence. We earn and retain this by providing high quality services which are understood by our clients to rest upon high degrees of transparency, objectivity and independence, and by carrying out our duties solely in the best interest of our investor clients.

Among other things, ISS supplies a comprehensive Due Diligence compliance package on its public website for the benefit of all market participants and the public and to assist our clients in fulfilling their own obligations regarding the use of independent, third-party providers. ISS has implemented comprehensive disclosure and quality assurance practices which are described in more detail below.

The ISS ESG Product Suite

ISS ESG offers a comprehensive suite of data and solutions for institutional investors. ISS ESG ratings covering publicly traded issuers are exclusively offered on an investor-pay model.

The following ESG data products comprise the portfolio of solutions currently marketed and sold by ISS ESG:

- **Climate Solutions**, including Carbon Footprint Data, Climate Impact Data, Portfolio-Level Reporting, Strategy Development and Advisory Services.
- **Ratings and Rankings**, including ESG Corporate and Country Ratings, Carbon Risk Rating, Fund Ratings, Custom Ratings and Rankings, Municipal Bond Rankings and Scores, and Quantitative ESG Raw Data.
- **Impact and SDG Solutions**, including SDG Impact Ratings and SDG Solutions Assessments data.
- **Screening & Controversies**, including Norm-Based Research, Country Controversy Assessment, Controversial Weapons Research, and screening on Sector-Based Issues, Energy & Extractives and Global Sanctions.
- **Stewardship and Engagement**, including the ISS ESG Norm-Based Engagement Solution and the Thematic Engagement Solution.
- **Specialty Score & Data** including Director Data, Governance QualityScore, E&S QualityScore,
- **ESG Index Solutions**, including turnkey and custom options.
- **Data Strategy**, including Data Governance and Data Science to help clients build and maintain robust, transparent and efficient workflows, ensure data integrity and alignment with recognized standards.
- **Integrated Financials and Impact**, including Economic Value Added (EVA)-based research.
- **Regulatory Solutions**, including the EU Taxonomy Alignment Solution, SFDR Principal Adverse Impact Solution, Labels & Standards Solution.

ISS ESG data and analysis can also be used by clients in their customized models. In addition, ISS ESG data and research can inform research and service offerings of other ISS business units. For example, second party opinions ("SPOs") are sold and distributed by ISS Corporate Solutions ("ICS"), a wholly-owned subsidiary of ISS that offers solutions to corporate issuers, although the analytical work to prepare and issue SPOs is performed by ISS ESG. The fact that ICS receives a fee is not a factor in ISS ESG's preparation of the SPOs and the results thereof. We explain ISS' policies and procedures for identifying, disclosing and managing actual and potential conflicts of interest in a dedicated section below.



Use of ESG Ratings

Investor demand for ESG data and analysis has grown substantially over the last few years, motivated by factors ranging from regulatory requirements, the requirements of asset owners, voluntary standards around ESG factor integration, corporate and investor commitments, and, importantly, the recognition that material ESG risks are integral to fundamental investment analysis. Asset owners and managers are not of a single mind with respect to ESG factors or how to best incorporate ESG ratings into their investment processes, if at all. Institutional investors come to ISS ESG for the research, specialized expertise, efficiency, and scale across a variety of complex ESG issues and regulatory demands.

In our experience, ESG ratings typically do not unilaterally impact capital allocation and investment decisions; rather, they are used as a “flag” or a “signal,” meaning a starting point from which asset owners and managers further their investment analysis of a particular company, sector or industry. Some investors may use ratings to facilitate a top-down assessment of portfolio risk exposure, from reputational and business risks arising from controversies, such as breaches of global norms, to risks arising from climate change (both physical and transitional); while others use ratings in their bottom-up stock selection, to identify material ESG issues, as well as to measure performance against ESG targets. Other use cases range from performing best-in-class analysis, conducting screening, actioning thematic investing to incorporation in stewardship and voting activities. Specific data underpinning the ISS ESG Corporate ratings, for example, can also flow into our clients’ own proprietary evaluation tools and models.

Ultimately, as with any investment analysis tool, it is up to our clients, the asset owners and managers, to determine how to best incorporate ESG ratings into their investment decision-making process. Institutional investors are sophisticated, professional users of financial data who use ESG ratings as part of a comprehensive array of investment analysis tools to understand and manage portfolio risk and opportunity and to implement their respective (and often differing) investment and stewardship philosophies.

Methodology Transparency & Research Quality

ISS ESG is dedicated to a high level of public transparency across our ESG research solutions. We provide market participants and the public with relevant information to understand how ISS ESG operates and the basis upon which we generate our analyses, form our conclusions and develop our assessments.

ISS ESG has a dedicated public [Methodology Information](#) webpage outlining our ESG research methodologies and the quality and research processes spanning our various ESG solutions. As an example, the public disclosure for the ISS ESG Corporate Rating includes the measurement objective of the ESG rating, the principal sources of qualitative and quantitative information used in the assessment, how absence of information was treated; along with the time horizon of the assessment. Our methodology transparency ensures credible and reproducible results, serves to engage rated/analysed issuers and allows for flexible use and customization of deliverables by our investor clients.

Additionally, via the [ISS ESG Gateway](#), ISS, on a voluntary basis, offers free public access to a range of high-level ISS ESG corporate ratings and scores as well as fund ratings. These include ESG Corporate Ratings, Governance QualityScores, SDG Impact Ratings, and ESG Fund Ratings. The portal provides ratings and scores on more than 6,100 corporations across the globe, including roughly 3,000 in the Americas, 1,700 in EMEA, and 1,400 in Asia-Pacific, as well as ratings for approximately 30,000 funds spread across 45 jurisdictions. Information provided via the ISS ESG Gateway is updated monthly to reflect any changes to an entity’s rating or score, and we plan to expand the list of available ratings.



In general, ISS ESG believes the need for public transparency needs to be carefully balanced to facilitate clarity while fostering an innovative and competitive marketplace. Providers need to have the freedom and flexibility to preserve their work product and the underlying research and development. This is particularly true for the relatively nascent and evolving ESG data market, where competitive differentiation encourages new market entrants, fosters innovation and offers investors the choice they demand.

Quality Assurance

ISS ESG employs robust systems and controls designed to ensure the quality and independence of our research. With respect to quality assurance, we have developed the following approach across our research offerings:

- **Sound Knowledge-Management Program:** documented reliable structures and processes through business-process mapping and internal dashboards to ensure objectivity and accuracy of research production and implementation.
- **Internal Controls:** established internal controls to monitor methodology alignment, accuracy and completeness of information. This applies to both research content and underlying processes.
- **Quality Management:** a process-focused program that leads the knowledge management and internal control functions within ESG research and sits within ISS ESG's Methodology team.
- **Quality Assurance:** implementation of a team dedicated to content assurance that is independent of the production teams and randomly samples research to enhance and ensure accuracy, above all else, and that professional standards are met and exceeded.
- **Functional and Independent Structures:** separation and reporting of the ESG Research team from any commercially driven functional teams, including product, sales and client success.
- **Global Methodology Governance Structure:** structure encompasses three cross-functional teams across ISS ESG: (1) **Global ESG Methodology Team** works closely with the Product and Research teams and additional stakeholders to initiate, develop and agree upon proposed and required methodology developments and enhancements; (2) **Methodology Review Board** which works to ensure a robust and consistent methodology development process and structure, consisting of highly experienced methodology and research leaders; (3) **Market Input Steering Committee** tasked with prioritizing evolving global market demands and regularly informing methodology development.

Data Collection & Engagement with Rated Companies

ISS ESG's data and research are primarily based on publicly available data and alternative, non-material data sources. Public company disclosure (e.g., annual company reports, corporate sustainability reports, company websites) accounts for an overwhelming majority of processed ISS ESG data.

During the research phase, ISS ESG may engage in a targeted dialogue with covered entities and key stakeholders to confirm that the information obtained from public sources is complete, accurate and up to date. This may extend to a fact-finding dialogue with companies to obtain supplementary detail and confirmation of activities, commitments and practices. In general, to enhance the quality, credibility, completeness, and usefulness of the ESG assessments for our investor clients, ISS ESG may accept supplementary non-public official company documents if the information is considered *non-material*, but ISS ESG does not accept or incorporate any *material* non-public information (meaning, generally, information that a reasonable investor would consider important in making an investment decision or information that is likely to have a substantial effect on the price of a company's security).



In addition, ISS ESG provides companies access to key ISS ESG research reports and the opportunity to review for factual accuracy the ESG Corporate Rating, Norm-Based Research and Controversial Weapons Research.

We note that ISS' approach is voluntary and motivated by a series of unique factors, including the current state of public company reporting, particularly for small and mid-size enterprises and those in emerging markets, and the fact that ESG expectations of public companies are quickly evolving.

In general, ISS ESG takes an open and transparent approach in relation to corporate issuers and seeks to provide issuers with insight into and understanding of our research processes and methodologies as well as the data and analyses that are integrated into our reports. Final versions of certain ISS ESG research reports are available to the covered issuer free of charge. Companies can also obtain further background via the [ISS ESG Research Guide for Corporate Issuers](#). Questions and feedback can be submitted through our central ESG Helpdesk via ESGHelpdesk@iss ESG.com.

Identification, Management and Disclosure of Conflicts

ISS understands and takes extremely seriously the potential for actual or perceived conflicts of interest, which might impact the integrity of our research and services. We strongly agree that ESG ratings and data product providers should take meaningful steps to eliminate or to manage and disclose all perceived or actual conflicts of interest. For the avoidance of doubt, the response below details the protocols for the identification, management and disclosure of possible conflicts of interest across all of ISS' business units.

First and foremost, ISS addresses conflicts of interest by being a transparent, policy-based organization. ISS has implemented extensive policies and procedures to identify, manage and disclose conflicts of interest, and has adopted controls reasonably designed to manage each of those risks. These policies are intended to establish appropriate standards and procedures to protect the integrity and independence of the research, recommendations, ratings, and other analytical offerings ("Research Offerings") produced by ISS.

ISS provides its institutional investor clients with extensive information to ensure that they are fully informed of potential conflicts and the steps that ISS has taken to address them. As noted earlier, among other things, ISS supplies a comprehensive [Due Diligence](#) section on its public website. This section of the ISS website includes an area specifically dedicated to the policies, procedures and practices regarding potential conflicts of interest.

In addition, many of ISS' clients conduct their own due diligence regarding the way ISS implements the procedures governing conflicts and perform diligence calls and visits to satisfy themselves that ISS' rules governing conflicts are robust and effectively adhered to.

Code of Ethics

ISS has adopted a [Code of Ethics](#) which affirms ISS' relationship of trust with its clients and obligates ISS to carry out its duties solely in the best interest of clients and free from all compromising influences and loyalties.

The Code of Ethics devotes special attention to preventing and disclosing conflicts of interest. In this regard, the Code of Ethics addresses the potential conflicts between the company's research teams and other services provided by subsidiaries or affiliates, conflicts within the institutional advisory business, conflicts arising from an analyst's stock ownership, conflicts in connection with an issuer's review of a draft ISS report, and conflicts generally. In each case, the goal of the Code of Ethics is to prevent conflicts wherever possible, and more generally to manage and disclose potential or actual conflicts.



General Code of Conduct

Additional to the Code of Ethics, the [General Code of Conduct](#) is a broad-based “good practices” code that provides a framework to address general corporate policies and practices that apply to ISS as a global business. ISS employees subject to the Code of Ethics or General Code of Conduct are required to complete training related to these documents as well as certify their adherence upon hire and on an annual basis thereafter.

The areas covered in the General Code of Conduct include:

- Doing the Right Thing;
- Protecting the Company’s Interests;
- Safeguarding and Maintaining Information;
- Treat Others with Dignity and Respect;
- Promote a Safe and Healthy Working Environment;
- Violations of the General Code of Conduct;
- Reporting Concerns; and
- Compliance Requirements.

Conflict Management and Mitigation

ISS routinely reviews its business lines to identify and reasonably address potential conflicts of interest. In general, ISS has identified three primary types of potential conflicts:

- the relationship between ISS and its majority owner, Deutsche Börse AG;
- a relationship between ISS and an institutional client where that client could seek to inappropriately influence the advice given to other institutional clients; or
- a client relationship between a corporate issuer and ISS’ wholly-owned subsidiary, ISS Corporate Solutions, Inc. (“ICS”).

Concerning the first potential conflict, Deutsche Börse AG (“DB”) owns an approximate 82% stake in ISS HoldCo Inc., the non-operating holding company which wholly owns ISS. The remainder of ISS HoldCo Inc. is held by a combination of Genstar Capital (“Genstar”), a private equity firm, and ISS management. ISS has formally adopted [Policies on Non-Interference and Potential Conflicts of Interest](#) related to DB, Genstar and the board of directors of ISS HoldCo Inc. These policies are intended to establish appropriate standards and procedures to protect the integrity and independence of the Research Offerings produced by ISS and to safeguard the reputations of ISS and its owners.

Concerning the second potential conflict, ISS is a policy-based organization and uses a series of published methodologies that provide a very practical check and balance to ensure the integrity and independence of ISS ESG’s ratings and data products. ISS research analysts follow these comprehensive policy guidelines when conducting research for the benefit of clients.

The third potential conflict is between ISS’ core business for the benefit of institutional investors and the work of ICS, which sells analytic tools and services directly to issuers. ISS is transparent about its ICS business and the entire business is described in detail on our public [website](#). ISS provides institutional clients the ability to obtain information regarding ICS’ dealings with corporate issuers, including the amount of compensation that the firm has received or will receive from the issuer. ISS’ standard institutional client contract contains disclosures regarding ICS and its work with corporate issuers.



In general, we believe that ICS' work with corporate issuers helps companies better understand the ESG expectations of their shareholder bases and empowers them to enhance their practices, which ultimately benefits all shareholders. At the same time, we understand the potential for conflict that arises when ICS provides advice to an issuer on which ISS ESG provides research coverage, and we therefore take a number of measures to prevent such a potential conflict from becoming an actual conflict. We manage this through a combination of disclosure to clients, consistent and transparent application of methodologies, a robust compliance program and implementation of a firewall designed to prevent information flows around the identity of the ICS clients.

Beyond disclosure, a critical component of ISS' approach to managing the potential conflict of interest arising from ICS' business is the firewall it maintains between its business for institutional investors and the services offered by ICS to corporations. This firewall includes the physical, functional and technological separation between ICS and ISS, with a particular focus on the separation of ICS from the ISS business units which provide its Research Offerings. A key goal of the firewall is to keep the relevant teams providing ISS' Research Offerings from learning the identity of ICS' clients, thereby helping to ensure objectivity and independence.

The firewall mitigates potential conflicts via several layers of separation:

- ICS is a separate legal entity from ISS.
- ICS is physically separated from ISS and its day-to-day operations are separately managed.
- ISS' research team works independently from ICS.
- ICS and ISS staff members are prohibited from discussing a range of matters, including the identity of ICS clients.
- ISS employees' salaries, bonuses and other forms of compensation are not linked to any specific ICS activity or sale. ICS explicitly informs its corporate clients that ISS will not give preferential treatment to, and is under no obligation to
 - support any proxy proposal of a corporate issuer nor
 - provide a favorable rating, assessment and/or any other favorable result to a corporate issuer whether or not that corporate issuer has purchased products or services from ICS.

Policy Regarding Disclosure of Significant Relationships

ISS has also adopted a [“Policy Regarding Disclosure of Significant Relationships.”](#) In brief, this policy includes as “significant” the relationships ISS has with issuers that are clients of ICS, and information about those issuers is made available to clients as noted in the prior section.

The policy also makes provision for disclosure of relationships with institutional clients that are publicly traded (or are part of a publicly traded group), as well as clients that act as shareholder proponents, in light of the potential that such a client might use the relationship with ISS, and the revenue provided by the client to ISS, to try to exert inappropriate influence on ISS' research and voting recommendations. Under the circumstances of these relationships and the nature of the potential conflict, the assessment of whether a relationship is “significant” is subject to a specified threshold of the percentage of overall revenue provided by the subject client. The relationship with DB is also considered “significant” by virtue of it being a majority owner of ISS.

We believe that these disclosures are an effective and transparent way of disclosing to our institutional investor clients relevant information without compromising the effectiveness of the ISS firewall.

