S&P's decision to drop ESG ratings garners mixed reactions from industry

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S&P Global Ratings' recent decision to discontinue issuing environmental, social and governance credit indicators as part of its ratings analyses has elicited mixed responses from asset managers and other stakeholders and cheers from Republican politicians.

Specifically, on Aug. 4, S&P Global announced it will cease publishing alphanumeric ESG credit indicators for publicly rated entities. S&P had commenced issuing ESG scores for public companies in 2021.

Elizabeth Levy, Boston-based head of ESG strategy and portfolio manager at Trillium Asset Management, said S&P's decision is unlikely to sway investors one way or the other.

"While it is possible that the decision was not politically motivated, it certainly seems that it was, given the timing amidst all of the anti-ESG rhetoric flying around," she said by email.

ESG needs to be considered from both a quantitative and qualitative perspective, and simply using a formula or algorithm to crunch numbers fails to capture the real power of essence of ESG information, she added.

"I don't think that many investors will be swayed either way by this change," Ms. Levy stated. "Investors either think there is utility in using this information, as we do, or they think that there is no benefit, and a seemingly political choice by S&P is unlike to shift investors between those camps."

Trillium has $5.4 billion in assets under management.

Eric Borremans, Geneva-based head of ESG at Pictet Asset Management, noted that S&P's decision does not impact his firm.

Pictet, he said by email, makes limited use of ESG ratings due to the fact that most methodologies tend to average ESG risks and opportunities into one numeric value, thereby assuming that strengths in some areas may offset material weaknesses in other unrelated areas.

"We are not in a position to second guess S&P's motivations," Mr. Borremans added. "However this decision is taken at a time where one can expect additional scrutiny from regulators on ESG ratings in order to enhance transparency and reliability."

Pictet has $66 billion in assets under management.

Andrew Poreda, Austin, Texas-based vice president and senior research analyst on Sage Advisory's ESG and Impact Investing Team, said from a practical perspective, this move likely won't have too much impact on asset managers unless they were subscribed to S&P and actively used those indicators.

Mr. Poreda also found S&P's decision perplexing since the agency has "put so many resources into both offering ESG-relevant services and providing valuable thought leadership for a myriad of ESG topics."

In fact, Sage had viewed them as a pivotal leader in bringing ESG to the forefront of the investing ecosystem, he added.

Sage manages approximately $21 billion.

S&P's move to get rid of the ESG ratings when assessing credit quality should be taken as a sign that S&P might be getting back to the job of assessing credit quality, said David Bahnsen, Newport Beach, Calif.-based CIO of The Bahnsen Group, which has $4.5 billion in AUM.

Asset managers, he added, benefit from rating agencies focusing on their traditional strengths. "When asset managers have to worry that even something as objective as creditworthiness is being politicized or influenced by outside ideological forces, it forces asset managers to discount that rating agency assessment accordingly," Mr. Bahnsen added.

Ethan Powell, CEO of Impact Shares, an ETF issuer based in Dallas, Texas, said S&P's move was more of a reflection of the difficulty in assigning numerical values to qualitative social and environmental factors.

"This may stem from the market's scrutiny of the comparability between ratings methodologies and the political and regulatory interest in how ESG is used in portfolio management as well as advertising," he said. "We believe this is a natural evolution of how social and environmental outcomes are considered when assessing financial risk/return and is not reflective of a lack of investor demand for consideration of these factors."

Republican support

While the reaction by asset managers to the rating agency's decision was muted, it was roundly hailed by some Republican lawmakers who have railed against so-called "woke investing."

Rep. Andy Barr, R-Ky., tweeted on Wednesday that "ESG ratings distort the free market. Lending decisions should be made based on creditworthiness, not the political preferences of the Left and Wall Street elitists."

Similarly, Sen. Mike Braun, R.-Ind., said on Wednesday on the social media platform: "ESG is designed to tank your hard-earned retirement savings to support radical woke agendas. Fiduciaries should be concerned with maximizing return on investment before anything else."

Jimmy Patronis, chief financial officer of the State of Florida, which has been a focal point of the anti-ESG movement led by Republican Gov. Ron DeSantis, tweeted on Tuesday: "There was a real risk that these debt ratings agencies were going to shove ESG down states' throats. The threat was real: adapt ESG criteria in your investment decisions or we're downgrading you. The S&P abandoning this woke-virus helps removes that threat. Huge victory."

Competitive impact

How will S&P's move impact the other big ratings agencies?

Mr. Bahnsen said the other rating agencies that were "bullied" into using ESG scores in their credit rating methodology now have a choice. "Allow S&P to be the only credit rating agency that is really rating credit, and suffer the fallout competitively, or follow suit and return to the job they signed up for," he said.

But Mr. Poreda does not see this step as a big win for other ratings agencies, at least in the U.S.

"With the oligopoly that Moody's and S&P control for both corporate and municipal bond issuers, working with them has become a cost of doing business," he said. "However, S&P's lack of conviction over the topic of ESG could influence the marketplace for other ESG-relevant products and services offered by service providers. It is going to be a hard message for S&P to craft that other ESG-relevant tools are still important for clients when you just removed them from your flagship product."

The SEC declined to comment.

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