

# HOW TO CURB ANTI-ISRAEL BIAS IN ESG RISK RATINGS

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*Morningstar thinks an outside investigation of Sustainalytics solved its anti-Israel bias. The report, however, reveals just how pervasive and systemic that bias remains.*

## OVERVIEW

Last year, Morningstar, Inc. hired outside law firm White & Case LLP to conduct an investigation into allegations that: 1) Morningstar’s environmental, social, and governance (ESG) research subsidiary, Sustainalytics, negatively rates companies doing business in Israel, based on politically biased information; and 2) Sustainalytics at times serves as a conduit for the Boycott, Divestment, Sanctions (BDS) campaign targeting Israel.<sup>1</sup> On June 2, following the conclusion of that investigation, Morningstar Executive Chairman Joe Mansueto and Chief Executive Officer Kunal Kapoor released White & Case’s final, 117-page investigative report (the “Report”).<sup>2</sup>

In the introduction to its Report, White & Case presents three core conclusions of its investigation:<sup>3</sup>

- 1) “Morningstar’s Sustainalytics products do not recommend or encourage divestment” from Israel or from companies connected to Israel.
- 2) “The investigation found neither pervasive nor systemic bias against Israel in Sustainalytics’ products or services.”
- 3) “[T]he independent investigation did find scattered instances of processes and procedures which can be improved.”

Mansueto and Kapoor have touted these findings, including in a June 2 public statement, as evidence supporting Morningstar’s prior assertions that “[n]either Morningstar nor Sustainalytics supports the anti-Israel BDS campaign.”<sup>4</sup>

1. Asaf Shalev, “Is finance giant Morningstar boycotting Israel? A new BDS battlefield emerges in investing world,” *Jewish Telegraphic Agency*, February 8, 2022. (<https://www.jta.org/2022/02/08/israel/is-finance-giant-morningstar-boycotting-israel-a-new-bds-battlefront-emerges-in-investing-world>)

2. Tara Lee, “Report of Independent Investigative Counsel Regarding Alleged Anti-Israel Bias in Morningstar, Inc. ESG Products and Services,” *White & Case LLP*, May 11, 2022. ([https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt14225aa50ae4fa4d/2022-05-11\\_Report\\_of\\_Independent\\_Investigative\\_Counsel\\_\(Final\).pdf](https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt14225aa50ae4fa4d/2022-05-11_Report_of_Independent_Investigative_Counsel_(Final).pdf))

3. *Ibid.*, pages 4-5.

4. Joe Mansueto and Kunal Kapoor, “A Letter from Joe Mansueto and Kunal Kapoor,” *Morningstar*, June 2, 2022. (<https://www.morningstar.com/company/esg-research-integrity>)

Yet, notwithstanding the conclusions set forth at the beginning of the Report, the evidence collected and presented in the Report tells a different story. On a full reading of the Report, rather than exonerating Morningstar, the White & Case investigation instead demonstrates conclusively that Sustainalytics' processes and products — including its flagship ESG Risk Ratings product — are infected by systemic bias against Israel. Specifically, the Report conclusively demonstrates that:

- 1) Sustainalytics relies heavily, if not quite exclusively, on deeply flawed, anti-Israel sources, including anti-Israel non-governmental organizations (NGOs) such as Who Profits, Human Rights Watch, and Amnesty International.<sup>5</sup>
- 2) Companies that are in any way involved in the Israeli economy are automatically identified as complicit in human rights abuses in all Sustainalytics' core products and are thus disproportionately punished in Sustainalytics ratings compared to companies doing business in any other country.<sup>6</sup>

In response to the Report, Morningstar announced that it would implement minor remedial measures to enhance the transparency and reliability of its ESG products.<sup>7</sup> While a modest start, these measures are not sufficient to address the underlying and pervasive anti-Israel biases revealed in the Report. In addition to the minor remedial steps Morningstar announced it would take to address concerns of bias within Sustainalytics, Morningstar must:

- 1) Prohibit reliance on biased and radical anti-Israel sources;
- 2) Remove Israel from the list of conflict zones that automatically trigger a response by Sustainalytics' Incidents team; and
- 3) Address, across all its core products, the root causes of Sustainalytics' problematic downgrading, based on alleged but unfounded complicity in human rights violations, of companies that do business in Israel.

Importantly, Morningstar commissioned White & Case only after the Illinois Investment Policy Board launched an investigation into whether the company engages in activities that constitute a boycott of Israel, which would require the Illinois state pension funds to divest from Morningstar. With more than 30 states across the country having enacted similar anti-boycott laws, state officials should press Morningstar to continue making improvements to remove the pervasive and systemic bias against Israel inside Sustainalytics. They should also press other firms that produce ESG research and ratings to demonstrate that they do not follow Sustainalytics' practices.

## **MORNINGSTAR MUST END ITS RELIANCE ON ANTI-ISRAEL SOURCES**

One of the primary drivers of Sustainalytics' pervasive and systemic bias against Israel is its use of radical anti-Israel sources. Indeed, Sustainalytics is at least partially aware that this is a problem that leads to erroneous ratings and reports. The Report recounts a series of actions taken by Sustainalytics to prevent reliance on certain extreme

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5. Tara Lee, "Report of Independent Investigative Counsel Regarding Alleged Anti-Israel Bias in Morningstar, Inc. ESG Products and Services," *White & Case LLP*, May 11, 2022, pages 69-73. ([https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt14225aa50ae4fa4d/2022-05-11\\_Report\\_of\\_Independent\\_Investigative\\_Counsel\\_\(Final\).pdf](https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt14225aa50ae4fa4d/2022-05-11_Report_of_Independent_Investigative_Counsel_(Final).pdf))

6. *Ibid.*, pages 86-93.

7. Joe Mansueto and Kunal Kapoor, "A Letter from Joe Mansueto and Kunal Kapoor," *Morningstar*, June 2, 2022. (<https://www.morningstar.com/company/esg-research-integrity>)

and unreliable sources of anti-Israel propaganda, including the *Electronic Intifada* website, *BDSMovement.net*, *Iran Daily*, and the Venezuelan regime-sponsored television network Telesur.<sup>8</sup>

Despite these efforts, the Report makes clear that Sustainalytics continues to rely on other anti-Israel sources. For example, both Human Rights Watch and Amnesty International, which the Report identifies as primary sources for Sustainalytics in its assessment of Israel-related companies, are well known for their anti-Israel bias.<sup>9</sup> Recently, leading Democrats in Washington blasted Amnesty for falsely labeling Israel an apartheid state.<sup>10</sup>

More alarmingly, the Report makes clear that “in the context of research involving the Israeli/Palestinian conflict areas,” Sustainalytics relies on an NGO called Who Profits for the company’s Global Standards Screening (GSS) and Global Standards Engagement (GSE) products. Who Profits is an extremist anti-Israel organization and leading BDS proponent and was instrumental in helping the Office of the United Nations High Commissioner for Human Rights construct its blacklist of Israeli-connected firms.<sup>11</sup>

The Report noted that “communications between Sustainalytics employees and representatives of Who Profits suggest that the relationship between the entities is close, relative to Sustainalytics’ relationships with other organizations.”<sup>12</sup> The Report references employees as saying Sustainalytics “research analysts often rely upon Who Profits for what they view as unique, boots-on-the-ground research regarding corporate involvement in the region.” One employee “described the relationship with Who Profits as being somewhat distinct from other NGO sources, as Sustainalytics is familiar with Who Profits’ research approach, and thus analysts will sometimes contact Who Profits directly to ask clarifying questions or obtain additional information.”<sup>13</sup> Sustainalytics researchers “expressed reluctance to disregard Who Profits as a source entirely, in part because it provides a boots-on-the-ground perspective regarding the Israeli/Palestinian conflict areas due to its physical presence there,” and defended “the value of information provided by Who Profits.”<sup>14</sup> Notably, Sustainalytics’ guidelines for adding companies operating “in Israeli-Palestinian conflict areas” to its GSS “Watchlist” closely align with several “corporate involvement” categories tracked by Who Profits.<sup>15</sup>

The Report also noted that Sustainalytics can and does rely on the United Nations’ anti-Israel blacklist for its ESG ratings and reports. According to the Report, Sustainalytics’ Controversies Research product “does cite ...

8. Tara Lee, “Report of Independent Investigative Counsel Regarding Alleged Anti-Israel Bias in Morningstar, Inc. ESG Products and Services,” White & Case LLP, May 11, 2022, page 72. ([https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt14225aa50ae4fa4d/2022-05-11\\_Report\\_of\\_Independent\\_Investigative\\_Counsel\\_\(Final\).pdf](https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt14225aa50ae4fa4d/2022-05-11_Report_of_Independent_Investigative_Counsel_(Final).pdf))

9. Ron Kampeas, “Human Rights Watch says Israel has crossed ‘apartheid’ threshold,” *Jewish Telegraphic Agency*, April 28, 2021. (<https://www.jta.org/2021/04/28/united-states/human-rights-watch-says-israel-has-crossed-apartheid-threshold>); Israel Kasnett, “Israel defenders slam Amnesty International over ‘diplomatic lynch against the Jewish state,’” *Jewish News Syndicate*, January 31, 2022. (<https://www.jns.org/amnesty-international-slammed-over-report-accusing-israel-of-apartheid-systematic-discrimination>)

10. Kate Scanlon, “Hoyer and Jewish lawmakers blast Amnesty International official's Israel comments as antisemitic,” *Washington Examiner*, March 14, 2022. (<https://www.washingtonexaminer.com/news/hoyer-and-jewish-lawmakers-blast-amnesty-international-officials-israel-comments-as-antisemitic>)

11. “Who Profits,” *NGO Monitor*, August 16, 2020. ([https://www.ngo-monitor.org/ngos/who\\_profits](https://www.ngo-monitor.org/ngos/who_profits))

12. Tara Lee, “Report of Independent Investigative Counsel Regarding Alleged Anti-Israel Bias in Morningstar, Inc. ESG Products and Services,” White & Case LLP, May 11, 2022, page 71. ([https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt14225aa50ae4fa4d/2022-05-11\\_Report\\_of\\_Independent\\_Investigative\\_Counsel\\_\(Final\).pdf](https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt14225aa50ae4fa4d/2022-05-11_Report_of_Independent_Investigative_Counsel_(Final).pdf))

13. *Ibid.*, page 70.

14. *Ibid.*, page 98.

15. *Ibid.*, page 79; “Involvement,” *Who Profits*, accessed on June 14, 2022. (<https://www.whoprofits.org/involvement/control-of-population>)

a company's presence on the UN High Commissioner's list as a source of potential legal and/or reputational risk for that particular issuer."<sup>16</sup> The Report also asserts that other UN resolutions and inquiries used by Sustainalytics are credible sources of reference. The United Nations, however, is not an unbiased source, particularly in the human rights realm — suffering from pervasive and systemic bias against Israel alongside the undue influence of prominent human rights abusing regimes that hold membership on the UN Human Rights Council. As the Foundation for Defense of Democracies previously documented, “if research firms are relying on UN data — such as blacklists of companies or reports published by the UN high commissioner for human rights — to inform ESG human rights ratings, they may be relying on incomplete, biased, or manipulated information.”<sup>17</sup>

To address the biased sourcing in the company's Israel-related research, the Report recommends that Sustainalytics merely provide a disclaimer noting that some of its sources could be considered pro-Palestinian.<sup>18</sup> Such a boilerplate disclaimer is insufficient to cure the fact that the inputs being used by Sustainalytics to evaluate Israel-connected companies are, in many cases, devoted to boycotts of the Jewish state. These inputs are deeply embedded in all Sustainalytics research products and make the research itself systemically biased against Israel and unreliable.

Morningstar should prohibit the use of sources that support or participate in the BDS campaign, including Who Profits, Human Rights Watch, Amnesty International, and the United Nations.

## **MORNINGSTAR MUST ADDRESS UNFAIR POLICY OF PUNISHING BUSINESSES JUST FOR OPERATING IN ISRAEL**

According to the Report, screening by Sustainalytics' “Incidents team ... provides the initial starting point for both the Controversies Research and GSS products.” According to the Incidents team's policies and procedures, “in occupied territories where human rights are being systematically violated, any business activity in that region is connected to the violations in some direct or indirect way.” The Report recommended that Sustainalytics describe “the specific assumptions made in the context of research and ratings related to the Israeli/Palestinian conflict areas, including the assumption that the territories are ‘occupied’ and that the settlements violate international law.” Thus, based on Sustainalytics' erroneous and unsubstantiated determination that Israel is engaged in the systematic violation of international law, any company doing business in or with Israel is deemed by Sustainalytics to be complicit in human rights abuses.<sup>19</sup>

It should come as no surprise, then, that White & Case's own quantitative analysis reveals that Sustainalytics disproportionately punishes companies for doing business in Israel. With respect to Sustainalytics' GSS product, White & Case found that the number of companies Sustainalytics rated for human rights violations based on their involvement in Israel was comparable to the number of companies similarly downgraded for operating in Pakistan, Saudi Arabia, and Western Sahara. With respect to Sustainalytics' GSE engagements, White & Case found that

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<sup>16</sup> Tara Lee, “Report of Independent Investigative Counsel Regarding Alleged Anti-Israel Bias in Morningstar, Inc. ESG Products and Services,” *White & Case LLP*, May 11, 2022, page 73. ([https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt14225aa50ae4fa4d/2022-05-11\\_Report\\_of\\_Independent\\_Investigative\\_Counsel\\_\(Final\).pdf](https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt14225aa50ae4fa4d/2022-05-11_Report_of_Independent_Investigative_Counsel_(Final).pdf))

<sup>17</sup> Richard Goldberg and David May, “Investors Should Demand Transparency From ESG Research Firms,” *Foundation for Defense of Democracies*, February 16, 2022. (<https://www.fdd.org/analysis/2022/02/16/investors-transparency-esg-research-firms>)

<sup>18</sup> Tara Lee, “Report of Independent Investigative Counsel Regarding Alleged Anti-Israel Bias in Morningstar, Inc. ESG Products and Services,” *White & Case LLP*, May 11, 2022, pages 97-99. ([https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt14225aa50ae4fa4d/2022-05-11\\_Report\\_of\\_Independent\\_Investigative\\_Counsel\\_\(Final\).pdf](https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt14225aa50ae4fa4d/2022-05-11_Report_of_Independent_Investigative_Counsel_(Final).pdf))

<sup>19</sup> *Ibid.*, page 95.

Sustainalytics' number of engagements with Israel-connected firms "did not substantively differ from the number of engagements with companies operating in China, Myanmar, Russia, Saudi Arabia, and Western Sahara."<sup>20</sup>

According to Freedom House, an international nonprofit that rates countries according to their freedom and liberties, Israel is a "Free" country, Pakistan is a "Partly Free" country, and China, Myanmar, Russia, Saudi Arabia, and Western Sahara are all "Not Free."<sup>21</sup> Grouping Israel, a free democracy, with authoritarian regimes for the purpose of research and ratings is itself a root cause of systemic bias.

Likewise, in its evaluation of Sustainalytics' flagship product, its ESG Risk Ratings reports, the White & Case Report found that "the Israeli-Palestinian conflict is responsible for a majority [70%] of the Occupied Territories/Disputed Regions incidents that led to a [heightened] human-rights related Controversy rating."<sup>22</sup> The Foundation for Defense of Democracies has previously documented other disputed territories that get little to no attention from Sustainalytics.<sup>23</sup>

Again, disclosure alone is not sufficient to address Sustainalytics' systematic bias against companies doing business in Israel. Morningstar must, at a minimum, remove the Israeli-Palestinian conflict from the Incidents team's purview and evaluate the underlying assumptions and personnel that have caused Sustainalytics to discriminate against the Jewish state, of all countries in the world.

## **STATE ANTI-BDS LAWS MAY APPLY TO MORNINGSTAR'S ANTI-ISRAEL RATINGS AND REPORTING**

After flatly denying any wrongdoing in a March 2021 public statement,<sup>24</sup> Morningstar faced the increasing possibility that states could prohibit investment in the company due to its promotion of boycotts against Israel.<sup>25</sup> Indeed, Morningstar's engagement of White & Case was prompted by Illinois' investigation into Morningstar's possible violation of the state's anti-BDS statute.

The White & Case Report itself contains substantial evidence that Morningstar is, in fact, promoting BDS among its customers and the investors that receive ESG ratings from Sustainalytics. As indicated above, Sustainalytics' ratings of companies doing business in Israel rely heavily on NGOs that expressly promote BDS. And notwithstanding the Report's conclusion that "Sustainalytics products do not recommend or encourage divestment,"<sup>26</sup> the evidence presented in the Report demonstrates otherwise:

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20. Ibid., pages 92-93.

21. "Countries," *Freedom House*, accessed on June 15, 2022. (<https://freedomhouse.org/countries/freedom-world/scores>)

22. Tara Lee, "Report of Independent Investigative Counsel Regarding Alleged Anti-Israel Bias in Morningstar, Inc. ESG Products and Services," *White & Case LLP*, May 11, 2022, page 91. ([https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt14225aa50ae4fa4d/2022-05-11\\_Report\\_of\\_Independent\\_Investigative\\_Counsel\\_\(Final\).pdf](https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt14225aa50ae4fa4d/2022-05-11_Report_of_Independent_Investigative_Counsel_(Final).pdf))

23. Svante Cornell and Brenda Shaffer, "Occupied Elsewhere: Selective Policies on Occupations, Protracted Conflicts, and Territorial Disputes," *Foundation for Defense of Democracies*, January 2020. (<https://www.fdd.org/wp-content/uploads/2020/01/fdd-report-occupied-elsewhere-selective-policies-on-occupations-protracted-conflicts-and-territorial-disputes.pdf>)

24. Morningstar, Press Release, "Morningstar Affirms Integrity of ESG Research and Ratings," March 16, 2021. (Archived version available at: <https://web.archive.org/web/20210418034901/https://www.morningstar.com/company/esg-research-integrity>)

25. Asaf Shalev, "Is finance giant Morningstar boycotting Israel? A new BDS battlefield emerges in investing world," *Jewish Telegraphic Agency*, February 8, 2022. (<https://www.jta.org/2022/02/08/israel/is-finance-giant-morningstar-boycotting-israel-a-new-bds-battlefront-emerges-in-investing-world>)

26. Tara Lee, "Report of Independent Investigative Counsel Regarding Alleged Anti-Israel Bias in Morningstar, Inc. ESG Products and Services," *White & Case LLP*, May 11, 2022, page 4. ([https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt14225aa50ae4fa4d/2022-05-11\\_Report\\_of\\_Independent\\_Investigative\\_Counsel\\_\(Final\).pdf](https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt14225aa50ae4fa4d/2022-05-11_Report_of_Independent_Investigative_Counsel_(Final).pdf))

Sustainalytics employees were emphatic that none of their research is intended to serve as a “blacklist”—i.e., an exclusionary list of companies in which clients must avoid investing, or must divest from if already an owner. However, employees also acknowledged that at least some clients may use their ESG products in this manner (particularly the GSS and Controversies Research products).<sup>27</sup>

That is not surprising. After all, why else would investors request ESG ratings and research reports if not to inform their investment and divestment decisions?

Worse still, the Report indicates that Sustainalytics may engage directly with companies to try to dissuade them from doing business in and with Israel. For example, the Report cites one Sustainalytics employee who “characterized the GSE engagement service as the opposite of divestment, as it consists of a dialogue with the engaged company that is designed to improve relationships between the investor-client and engaged issuer, rather than to punish the issuer.”<sup>28</sup>

To the extent that Sustainalytics encourages companies to cease doing business in Israel to improve their ESG ratings — which is precisely what would happen, according to the methodology set forth in the Report<sup>29</sup> — these interactions may amount to boycotts of Israel under numerous state anti-boycott laws.

In sum, not only are Morningstar’s ESG ratings and reports driven by a quantifiable bias against Israel, but by promoting boycotts of Israel, the company risks running afoul of numerous state statutes. For the sake of its shareholders, Morningstar should look beyond the misleading conclusions set forth at the beginning of the White & Case Report and address the root causes of the anti-Israel bias that the remainder of the Report makes glaringly obvious. States with anti-boycott laws will likely now review the Report and consider opening investigations into Morningstar to ensure further reforms are adopted.

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27. Ibid., page 74.

28. Ibid.

29. Ibid., pages 50-54.

## Foundation for Defense of Democracies (FDD)

FDD is a Washington, DC-based nonpartisan research institute focusing on national security and foreign policy.

## FDD's Center on Economic and Financial Power (CEFP)

FDD's Center on Economic and Financial Power studies national economic security, with a focus on how the U.S. can leverage its economic and financial power to achieve its national security objectives. CEFP promotes greater understanding of how the U.S. government can employ its economic and financial authorities to best counter its adversaries.

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