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# How to Assess Changes in Morningstar Sustainalytics ESG Ratings

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## Introduction

For more than a year, Morningstar Inc. has faced allegations that its environmental, social, and governance (ESG) research subsidiary, Sustainalytics, negatively rates companies doing business in Israel based on politically biased information.[1] The company has denied these allegations on multiple occasions: in March 2021 ahead of its annual shareholder meeting; in June 2022 alongside the release of a report from the law firm White & Case LLP, which supposedly cleared Morningstar of engaging in systemic bias; in a July 2022 *Wall Street Journal* letter; and in an August 2022 *Jerusalem Post* opinion piece.[2]

Morningstar now invariably points to the White & Case report, which Morningstar commissioned, claiming it found "no evidence Sustainalytics products recommended or encouraged divestment from Israel" and "no evidence of pervasive or systemic bias against Israel across Sustainalytics products, including the Sustainalytics ESG Risk Rating."[3] Yet as previous analysis from FDD has shown, White & Case reached these conclusions despite its own report documenting substantial evidence that did reflect systemic bias.[4]

If Morningstar's ESG ratings systematically discourage investment in Israel-connected firms, the company may be in violation of laws passed in more than 30 U.S. states that prohibit investments in or contracts with companies that boycott Israel.

**1.** Mike Wagenheim, "18 states join Missouri in probe of Morningstar's alleged biased anti-Israel ratings", *Jewish News Syndicate,* November 9, 2022. (https://www.jns.org/18-states-join-missouri-in-probe-of-morningstars-alleged-biased-anti-israel-ratings)
**2.** "Morningstar Affirms Integrity of ESG Research and Ratings," *Morningstar,* March 16, 2021. (https://web.archive.org/web/20210418034901/www.morningstar.com/company/esg-research-integrity); "A Letter from Joe Mansueto and Kunal Kapoor," *Morningstar,* June 2, 2022. (https://www.morningstar.com/company/esg-research-integrity); "Morningstar Responds on Ratings and Israel," *Wall Street Journal*, July 13, 2022. (https://www.wsj.com/articles/morningstar-ratings-sustainalytics-esg-bds-anti-israel-11657662969); Kunal Kapoor, "Morningstar does not support BDS – opinion," *Jerusalem Post* (Israel), August 29, 2022. (https://www.jpost.com/opinion/article-715787)
**3.** 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); "A Letter from Joe Mansueto and Kunal Kapoor," *Morningstar,* June 2, 2022. (https://www.morningstar.com/company/esg-research-integrity)
**4.** Richard Goldberg, "How to Curb Anti-Israel Bias Inside ESG Risk Ratings," *Foundation for Defense of Democracies*, June 17, 2022. (https://www.fdd.org/analysis/2022/06/17/how-to-curb-anti-israel-bias-inside-esg-risk-ratings)

This memorandum provides new information and detailed analysis of Morningstar Sustainalytics company profiles, ratings, and engagement reports based on direct access to the company's Global Access client platform, which Morningstar provided the author between August and November of 2022. The memorandum also draws on documents Morningstar provided to the author and more than two months of weekly 90-minute dialogue sessions the author held with senior Sustainalytics officials.

In summary, this analysis reveals evidence that:

**1.** Morningstar Sustainalytics has negatively rated companies doing business in Israel or territories controlled by Israel based solely on the fact that the companies do business in such areas;

**2.** Morningstar Sustainalytics has engaged in actions that penalize and have the effect of inflicting economic harm on, or otherwise limiting commercial relations with, companies operating in territories controlled by Israel;

**3.** Morningstar Sustainalytics has adopted core assumptions about the Israeli-Palestinian conflict that are biased against Israel and are used to justify negative ratings of companies either based on where they operate or because they provide goods or services connected to Israel's efforts to protect its citizens from terrorism;

**4.** Morningstar Sustainalytics' actions effectively supported the BDS campaign, proactively contacting companies targeted by the BDS campaign to warn them that activities in support of Israel's security constitute violations of human rights, effectively threatening that a failure to change course would result in Morningstar advising investors not to invest in the company; and

**5.** Morningstar Sustainalytics has relied on anti-Israel and antisemitic sources to justify anti-Israel assumptions and document corporate activities.

Morningstar allowed the author to use its Global Access platform with an understanding that analysis of its ratings could later be published. Morningstar reviewed this analysis prior to publication and responded as follows on October 26, 2022: "Unfortunately, it contains numerous factual inaccuracies and misrepresents our analytical processes and conclusions. Morningstar Sustainalytics does not harbor bias against Israel or support the BDS movement and the evidence overwhelmingly backs this up. We have shared this evidence with you and other members of the engagement team in good faith."[5]

On October 31, 2022, Morningstar publicly announced new "steps to address anti-Israel bias concerns in ESG research."[6] Those include:

**1.** Sustainalytics will provide additional documented guidance to ensure that its analysts understand that business activity, including but not limited to sectors such as telecommunications, banking, real estate, and construction, within the regions linked to the Israeli-Palestinian conflict or related to Israel's defense against terrorism, do not give rise to a presumption that there is a human rights concern.

**5.** Morningstar response after reviewing this analysis, October 26, 2022.
**6.** "Morningstar Announces Steps to Address Anti-Israel Bias Concerns in ESG Research," *Morningstar*, October 31, 2022. (https://shareholders.morningstar.com/newsroom/news-archive/press-release-details/2022/Morningstar-Announces-Steps-to-Address-Anti-Israel-Bias-Concerns-in-ESG-Research/default.aspx)

2. Sustainalytics will use geographic names (e.g., West Bank, East Jerusalem) in relevant regions, rather than terms such as "Occupied Palestinian Territory" or "occupied territory."

3. Sustainalytics will make several changes to hone its approach to media and other sources that it leverages as part of its research into companies' involvement in controversies:
   - remove sources that following a review with independent third-party experts are determined to be biased and unreliable;
   - limit mention of divestment activities if they do not create significant risk to a company and cannot be corroborated by additional approved sources;
   - remove references to the Boycott, Divest, and Sanctions campaign;
   - terminate the use of several sources, including the United Nations Human Rights Council, among others. As part of the sources review process, Sustainalytics will immediately suspend the use of Who Profits.

4. Sustainalytics will provide ongoing anti-bias and antisemitism training to research staff, including analysts, to continually work towards a goal of not having anti-Israel bias in sources and terminology and bolster in-house expertise with staff members focused on human rights and conflict zones.

5. Morningstar will seek advice regarding its assumptions, sources, and use of language from independent, recognized experts in international law, including international human rights law, who are well-versed in the policy, security, history, and religious and legal context of the Israeli-Palestinian dispute.

Questions, however, remain as to how these steps will be implemented, what other sources Sustainalytics will stop using, and whether existing ESG ratings, statuses, and engagements will change as a result. This memorandum provides a framework to assess future changes at Morningstar Sustainalytics and to compare research practices at other leading firms.

## Background on State Anti-BDS Laws

More than 30 states have adopted laws or executive orders related to boycotts of Israel. Some states prohibit contracting with companies that boycott Israel, while others mandate divestment of state funds, including pension fund investments, from such companies. Several states implemented these laws after Unilever subsidiary Ben & Jerry's announced a boycott of Israel.[7]

Legal definitions of "boycott Israel" vary by state. Arizona, for example, defines "boycott Israel" to include "actions that are intended to limit commercial relations with Israel or with persons or entities doing business in Israel or in territories controlled by Israel" if such actions are "based in part on the fact that the entity does business in Israel or in territories controlled by Israel."[8] Florida defines it to mean "refusing to deal, terminating business activities, or taking other actions to limit commercial relations with Israel, or persons or entities doing business in Israel or in Israeli-controlled territories, in a discriminatory manner."[9] New Jersey mandates divestment from a company that "boycotts companies operating in Israel or Israeli-controlled territory" and defines "boycott" to mean "engaging

**7.** Jacob Magid, "Illinois Divests Pension Funds from Unilever over Ben & Jerry's Settlement Boycott," *Times of Israel* (Israel), December 23, 2021. (https://www.timesofisrael.com/illinois-divests-pension-funds-from-unilever-over-ben-jerrys-settlement-boycott)
**8.** "Senate Bill 1167," *State of Arizona Senate*, 2019. (https://www.azleg.gov/legtext/54leg/1r/laws/0094.pdf)
**9.** *Florida State Senate*, 2016. (https://www.flsenate.gov/Session/Bill/2016/86/BillText/er/PDF)

in actions that are intended to penalize, inflict economic harm on, or otherwise limit commercial relations with another state or nation."[10]

Other states, like Missouri, use even broader discrimination language, defining "boycott Israel" to mean "engaging in refusals to deal, terminating business activities, or other actions to discriminate against, inflict economic harm, or otherwise limit commercial relations specifically with the State of Israel; companies doing business in or with Israel or authorized by, licensed by, or organized under the laws of the State of Israel; or persons or entities doing business in the State of Israel, that are all intended to support a boycott of the State of Israel."[11]

## Background on Morningstar's ESG Rating System and Key Products of Interest

### Global Access and Company Overviews

Sustainalytics offers multiple products, all of which are accessible via the company's Global Access system.[12] Global Access provides investors with an executive dashboard that offers an overview of any company of interest.

The firm's flagship product, the ESG Risk Rating, is an ESG version of a "Beta" value — a standard measure of volatility — whose purpose is to measure a company's total ESG-related investment risk. Sustainalytics calculates this value by weighing a long list of sustainability, environmental impact, social responsibility, and corporate governance risks facing a company against the extent to which such risk can be managed and any steps the company is taking to mitigate them.

Another product relates to "controversies" across areas of ESG interest, including human rights, which are ranked for severity from Category 1 to Category 5. The dashboard highlights the highest-ranking controversy associated with a company.

The dashboard also indicates whether the company appears on Sustainalytics' Global Standards Screenings (GSS) "watchlist" and whether a company is subject to an "engagement" by Sustainalytics.

Investors can click to go deeper into all these products, pulling up a comprehensive controversies report on the company, investigating why the company appears on a "watchlist," and reading detailed engagement summaries and years' worth of correspondence between Sustainalytics and companies deemed to be engaged in high-ESG risk activities.

### Controversies Research

Sustainalytics has an Incidents Team that scans various sources of information for corporate activity that may constitute a material ESG risk as defined by the company. Sustainalytics believes that certain activities constitute controversies of varying degrees if a company's conduct opens investors to material ESG risks, which in turn expose them to financial risks. These material risks are typically associated with corporate conduct that is ostensibly at

**10.** *New Jersey State Legislature,* accessed November 16, 2022. (https://pub.njleg.gov/bills/2016/PL16/24_.PDF)
**11.** "Senate Bill No. 739," *Missouri State Senate*, 2020. (https://www.senate.mo.gov/20info/pdf-bill/tat/SB739.pdf)
**12.** "Access to ESG Research, Screening, Reporting and Portfolio Monitoring Tools," *Sustainalytics*, accessed November 16, 2022. (https://globalaccess.sustainalytics.com)

odds with United Nations or other international standards related to sustainability and corporate governance. In the case of the Israeli-Palestinian conflict, however, the heart of the company's anti-Israel bias lies within its working assumption that corporate operations in certain territories or supporting certain activities constitute material ESG risk to investors. Sustainalytics, based on assumptions derived from anti-Israel sources, uses its own subjective judgement to label certain conduct by Israel-connected companies as controversies of varying degrees.

Global Access allows investors to run queries to generate lists of companies based on their highest controversy level. If investors wanted to generate a list of any company with a Category 3 "Significant" controversy rating for potential divestment, for example, they could easily do so. Investors may also search for standardized "system portfolios" that generate lists of companies with Category 4 or 5 controversies, companies flagged on the GSS watchlist, and/or companies involved in a Global Standards Engagement (GSE).

### Global Standards Engagement

In some cases, Sustainalytics has engagement teams contact companies to inform them that Sustainalytics has determined they are not complying with an international standard and invite them to enter a dialogue and discuss potential remediation or mitigation measures. Sustainalytics maintains records of the number of contacts made with a company over the life of an engagement and the number of meetings, conference calls, and correspondences. Global Access allows investors to pull up summaries and details regarding any engagement case, including a comprehensive "Dialogue Report" that documents every email Sustainalytics sent to or received from a company. Such records go back more than a decade.

In 2019, Sustainalytics acquired GES International, a "provider of engagement, screening and fiduciary voting services to institutional investors." According to Sustainalytics, "all of the roughly 65 GES employees, including the entire senior management team," were slated to join Sustainalytics.[13] Records reviewed for this analysis show that GES admitted in writing that it was recommending that investors exclude companies when those companies either declined to engage in dialogue or refused to change their behavior. Since the acquisition, correspondence does not appear to make such an explicit statement; instead, companies are placed into "disengage" status, with references to previous correspondence where exclusion from portfolios is associated with that term.

Sustainalytics' GSE Product Backgrounder, available on Global Access, defines "disengage" as either "poor or no progress and/or poor or no response from the company within a time period of two years after the start of the engagement" or "Companies whose business models rely on activities, such as involvement in controversial weapons, which would make engagement on these topics unlikely to be fruitful."[14]

The GSE portal on Global Access allows investors to filter engagement cases by "norm" (e.g., human rights) and engagement status (e.g., disengage) and then export all cases into an Excel spreadsheet — making it easier for investors to potentially group companies that they want excluded from their investment portfolios.

**13.** "Sustainalytics acquires GES International," *Sustainalytics,* accessed November 16, 2022. (https://www.sustainalytics.com/esg-news/news-details/2019/01/08/sustainalytics-acquires-ges-international)
**14.** "Global Standards Engagement – Product Backgrounder," *Sustainalytics*, February 2020, accessed November 16, 2022. (https://globalaccess.sustainalytics.com)

## Negative Impact on ESG Risk Rating Based on Location of Operations

A core premise of the BDS campaign has permeated Morningstar Sustainalytics' ESG risk assumptions: East Jerusalem, the entirety of the West Bank, Gaza, and the Golan Heights are deemed Occupied Palestinian Territories (OPT) where Israel is committing systemic human rights violations against Palestinians, and all companies operating in these areas are — based simply on their location — at risk of contributing to human rights abuses. This presumption of human rights risk triggers the company's incident team to investigate companies operating in or around these territories for controversy ratings and potential GSS watchlisting and GSE engagement.

In a document responding to questions on why an Israeli telecommunications company operating in the West Bank received a Category 3 Significant controversy rating, Sustainalytics wrote, "Our perspective is that the current operations in the Occupied Territories create an unmanageable human rights risk for the company."[15] That presumption upends the Oslo Accords, however, which allowed for an Israeli presence in various parts of the West Bank and which envisioned Israel retaining portions of the West Bank.[16] Notably, the presumption that any Israeli presence beyond Israel's 1967 border is a human rights violation is one of the same presumptions used by the BDS campaign. When the author asked why Sustainalytics would disregard the Oslo peace process and prejudge what the borders of Israel should be in final status negotiations, company officials appeared unfamiliar with the details of the Oslo Accords and the statuses assigned to different parts of the West Bank.

The company also pointed to divestments from companies operating in these areas (e.g., by Norwegian and Dutch pension funds) as proof that risks exist for investors. When asked for evidence that such BDS divestment campaigns result in financial harm to any given company — noting the booming Israeli economy and increased investment year after year — Sustainalytics claimed that such evidence is immaterial to risk calculus.

This approach leads to the infliction of harm on Israeli and Israel-connected companies. Israeli banks, for example, receive a Category 3 Significant controversy rating simply for providing services to Jews living in parts of Jerusalem — the capital of the Jewish state and home to the Western Wall — or the disputed West Bank.

Sustainalytics officials noted that some firms may be rated as Low Risk in their overall ESG Risk Ratings despite Category 3 Significant controversies — rendering the issue moot. Sustainalytics also insisted that none of its customers divest from companies based on a Category 3 Significant controversy rating — that divestment only happens at a Category 4 or above. This itself is an admission of knowledge that investors use its data to divest in certain cases — and a company like the Israeli defense contractor Elbit Systems is tagged with a Category 4 "High" controversy in connection with operations in the West Bank.

More importantly, this claim ignores the fact that, according to a senior Morningstar official, a Category 3 controversy alters a company's ESG Risk Rating by two to three points, which is not much less than a Category 4 label that alters the rating by five to six points.[17] Indeed, Sustainalytics decided to use the term "Significant

**15.** "Telecom Response," *Sustainalytics,* received on October 18, 2022.
**16.** "Israeli-Palestinian Interim Agreement on the West Bank and the Gaza Strip," September 13, 1995. (https://peacemaker.un.org/sites/peacemaker.un.org/files/IL%20PS_950928_InterimAgreementWestBankGazaStrip%28OsloII%29.pdf)
**17.** Meeting with senior Morningstar official, September 6, 2022.

Risk" to describe a Category 3 level controversy, which undermines any argument that Category 3 controversies are somehow insignificant.

The selective targeting of companies operating anywhere in territories controlled by Israel — a free and democratic country with rule of law — becomes apparent when compared to Sustainalytics ratings of companies operating in authoritarian regimes where human rights abuses are widely known to be occurring daily.[18] The highest controversy ratings attached to the Agricultural Bank of China, which operates in Xinjiang, are Category 2 Medium. The bank's only human rights controversy is a Category 1 Low related to continued operations in Russia following the invasion of Ukraine.

This biased and unfair treatment of Israeli companies extends beyond the banking sector. Bezeq, a leading Israeli telecommunications firm, has a Category 3 human rights controversy rating for merely operating in the West Bank. Notably, Sustainalytics writes in Bezeq's controversy report that while "there is no evidence of a direct impact on human rights violations or the potential facilitation of human rights violations through customized products or services … Bezeq's activities in the West Bank are a risk to its reputation, as many companies with involvement in the Occupied Territories face boycott, divestment, and sanctions campaigns from civil society groups worldwide." The statement suggests that the mere existence of the BDS campaign — regardless of its impact or the validity of its accusations — constitutes a material ESG risk to a company.

As one example that such risk exists, the report cites the UN Human Rights Office's blacklist of Israel-connected companies, a pillar of the BDS campaign. Cellcom Israel receives the same Category 3 controversy merely for operating in the West Bank. By contrast, China Telecom, China Mobile, and China Unicom's highest controversy ratings are Category 2 due to Washington's prohibition of investment in the companies because of their ties to the Chinese military. None of them earns a human rights controversy rating.

In the case of Africa-Israel Investments, Sustainalytics writes that the firm merits a Category 3 Significant controversy because the pro-BDS group Who Profits claims "construction projects in the West Bank and other areas in the occupied Palestinian territory serve the Jewish population and hinder the development of Palestinian cities." In effect, Africa-Israel Investments must stop serving Jewish populations if it wants to avoid a negative controversy rating from Sustainalytics. Sustainalytics also cites a Who Profits report criticizing Africa-Israel Investments for helping Israel construct a separation barrier between Israel and Gaza, with no apparent understanding that Gaza is controlled by Hamas, a U.S.- and European Union-designated foreign terrorist organization.

Sustainalytics also attaches controversies to several companies with operations in the Golan Heights, which the United States recognized as Israeli sovereign territory in 2019, based on pro-BDS sources.[19] The White & Case report revealed that Sustainalytics defines OPT to include the Golan Heights.[20]

**18.** "Israel," *Freedom House*, accessed November 16, 2022. (https://freedomhouse.org/country/israel)
**19.** "Proclamation on Recognizing the Golan Heights as Part of the State of Israel," *Trump White House*, March 25, 2019. (https://trumpwhitehouse.archives.gov/presidential-actions/proclamation-recognizing-golan-heights-part-state-israel)
**20.** 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 76. (https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt14225aa50ae4fa4d/2022-05-11_Report_of_Independent_Investigative_Counsel_(Final).pdf)

The examples provided here are representative and not an exhaustive list of companies or sectors targeted in this manner by Sustainalytics.

On its face, Morningstar Sustainalytics takes actions that effectively penalize Israel by discouraging investment in entities doing business in territories controlled by Israel solely because they do business in these territories — which may be a violation of state anti-BDS laws.

These concerns could be resolved by Morningstar's October 31 announcement depending on how steps are implemented. Removing the assumption that a human rights risk exists merely by operating within disputed territories related to the Israeli-Palestinian conflict should result in the removal of most human rights controversies attached to Israel-connected companies. If Sustainalytics, however, comes up with new justifications to maintain its negative ESG Risk Ratings, potential violations of state anti-BDS statutes may continue. Notably, since Morningstar's commitment does not mention the Golan Heights, a question remains as to whether controversy ratings connected to activity in the Golan will remain.

## Other Anti-Israel Biases Drive Ratings, Watchlisting, and Engagement

While the mere operation of a business in certain territories controlled by Israel has constituted a controversy for Morningstar Sustainalytics, some businesses get flagged for controversies based on their specific activities. As the company explains in its Global Standards Screening Methodology document, available on Global Access: "In the context of OPT, we consider companies that cause or contribute to stakeholder impacts through their products or services and exacerbate human rights violations to be exceptional. Our methodology prioritizes the most severe forms of corporate involvement in the OPT that might trigger a Watchlist or Non-Compliant status."[21]

One such trigger is the "supply of arms (according to the GSS criteria on arms trade)." The GSS arms trade framework for identifying a human rights risk states:

> There is evidence that a company exported or was involved in the export of conventional arms/military equipment to (local or foreign) parties known to systematically use them in attacks directed against civilians (with a severe impact on civilians), in particular attacks that may amount to atrocity crimes (genocide, crimes against humanity, war crimes), according to credible sources, and there is strong evidence that the arms/military equipment was used in these attacks. The provision of these weapons should fall within the duration of the conflict or time period within which the commission of human rights abuses took place.[22]

Sustainalytics apparently assumes there is evidence that the Israeli military systematically targets civilians.

Another trigger relates to the "supply of surveillance and identification equipment to monitor settlements at the wall and checkpoints directly linked to those settlements." The "wall" refers to the security barrier or fence erected by Israel to stop the wave of suicide bombings targeting buses, hotels, shopping centers, cafes, bars, and markets in the early 2000s. Bombings would often provoke Israeli military action targeting terror cells tied to the attacks. The security barrier proved effective in preventing these bombings — saving both Israeli and Palestinian lives.

**21.** "Global Standards Screening – Methodology Document," *Morningstar Sustainalytics,* 2020, accessed November 16, 2022, page 23. (https://globalaccess.sustainalytics.com)
**22.** Ibid., page 21.

However, Sustainalytics' research and ratings do not reflect that context. The company assumes the presence of a human rights violation — or risk thereof — for any firm providing services that support the barrier's operation. When asked why Sustainalytics does not consider the reason why the security barrier exists and whether its existence is beneficial for human rights by saving lives, company officials insisted their job is to focus solely on risks and that a human rights risk exists in this activity. Sustainalytics also noted that its ratings system can only score an incident in a single direction, positive or negative.

Based on this trigger, Morningstar places Illinois-based Motorola Solutions and Israeli defense contractor Elbit Systems on its GSS Watchlist. In its GSS report on Motorola Solutions, Sustainalytics primarily cites Who Profits, an organization dedicated to advancing BDS, in claiming Motorola Solutions' provision of a radar detection system to help stop terrorists from entering Israeli-controlled territory "enables the Israeli authorities to restrict Palestinians' freedom of movement as the system detects human movement near the settlements and the wall." Sustainalytics adds, "By providing surveillance systems to the wall and the settlements, Motorola directly helps Israel to uphold its control over Palestinians living in the West Bank."[23] This, of course, ignores the fact that Motorola Solutions and Elbit Systems are providing critical equipment to prevent suicide bombings and other attacks on civilians. Motorola Solutions gets a Category 3 Significant controversy rating for this activity.

In its GSS report on Elbit Systems, Sustainalytics again cites Who Profits as its primary source of information, calling the group "an independent research centre dedicated to recording the role of the private sector in the OPT." Sustainalytics writes, "By providing security systems to the wall, Elbit directly helps Israel to uphold its control over Palestinian population… Elbit's tailored intrusion detection systems enables the Israeli authorities to restrict freedom of movement of the Palestinian people." Elbit Systems gets a Category 4 High controversy rating for human rights.[24]

Elbit Systems' controversy rating may be higher than Motorola Solutions' because it is also "strongly criticized for the supply of unmanned aerial vehicles (UAVs), Skylark and Hermes 450 and 900, because they were allegedly used for surveillance and in attacks in which civilians were killed during military operations in Gaza in 2009 and 2014."[25] There is no evidence (and none is cited) of Israel ever systematically targeting civilians, which would be the only way to justify a GSS arms trade-related event, according to the Sustainalytics guidelines previously referenced.

Sustainalytics also fails to consider any background related to military operations in Gaza in 2009 or 2014, never mentioning that Hamas, an organization designated by the United States, European Union, and others as a foreign terrorist organization, controls Gaza nor that the Israeli operations came in response to Hamas' deliberate targeting of Israeli civilians with rocket attacks and the kidnapping of Israeli teenagers, respectively.

Due to their status as GSS watchlist companies, Motorola Solutions and Elbit Systems automatically become targets of the GSE engagement team.

Morningstar could resolve these concerns depending on how it implements its October 31 announcement. Removing the presumption that business activities related to Israel's defense against terrorism give rise to human

**23.** "SUSTAINALYTICS GLOBAL STANDARDS SCREENING - Q4 2022: Motorola Solutions, Inc," *Morningstar Sustainalytics,* accessed November 16, 2022. (https://globalaccess.sustainalytics.com)
**24.** "SUSTAINALYTICS GLOBAL STANDARDS SCREENING - Q4 2022: Elbit Systems," *Morningstar Sustainalytics,* accessed November 16, 2022. (https://globalaccess.sustainalytics.com)
**25.** Ibid.

rights risks should lead to the removal of controversies, watch-listing, and engagements with companies like Motorola Solutions and Elbit Systems. Otherwise, BDS activity may continue.

## Use of Anti-Israel and Antisemitic Sources

While Sustainalytics maintains that it relies upon thousands of sources to make ratings decisions, its controversy research connected to the Israeli-Palestinian conflict draws upon a relatively small pool of anti-Israel sources.

The UN Human Rights Council and the UN Human Rights Office employ double standards that result in relentless scrutiny of Israel while frequently ignoring the abuses committed by dictatorships that hold seats on the Council, such as China, Venezuela, and Cuba.[26] For example, at the behest of Beijing, the Council recently voted against debating the human rights situation in Xinjiang.[27] Nevertheless, the Council has condemned Israel roughly as many times as it has condemned the rest of the world's countries combined and it maintains a standing agenda item for only one country — Israel. Members of the Council's ongoing commission of inquiry into Israel face accusations of antisemitism from the U.S. government.[28] In 2020, the UN Human Rights Office published a blacklist of firms connected to Israel that allegedly contribute to human rights abuses merely by operating in disputed territory controlled by Israel.[29] The BDS National Committee welcomed the list and encouraged "strategic boycotts and divestment campaigns" against listed companies.[30]

As noted above, Who Profits is a non-governmental organization dedicated to BDS.[31] According to the White & Case report, "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."[32] Human Rights Watch and Amnesty International are also non-governmental organizations with known biases against Israel, including falsely accusing Israel of apartheid.[33]

**26.** Tzvi Kahn, David May, and Craig Singleton, "United Nations Human Rights Council," *Foundation for Defense of Democracies*," June 30, 2021. (https://www.fdd.org/analysis/2021/06/30/united-nations-human-rights-council)

**27.** Yuan Yang, "UN Human Rights Council Blocks Debate on China's Abuses in Xinjiang," *Financial Times* (UK), October 6, 2022. (https://www.ft.com/content/e00c7c4f-f28a-4d6e-b9a4-eb89df8d6d81)

**28.** US Mission Geneva, "Statement on Antisemitic Remarks by a Commissioner of the Israeli Coi," *U.S. Mission to International Organizations in Geneva*, July 28, 2022. (https://geneva.usmission.gov/2022/07/28/statement-on-antisemitic-remarks-by-a-commissioner-of-the-israel-coi)

**29.** Times of Israel Staff and AP, "The Blacklist: All 112 Companies UN Says are Operating in Settlements," *Times of Israel* (Israel), February 12, 2020. (https://www.timesofisrael.com/the-blacklist-all-112-companies-un-says-are-operating-in-settlements) Notably, Sustainalytics references a company's appearance on this list in its controversy analyses.

**30.** David May, "UN's New Anti-Israel Blacklist Condemns Companies for Generic Business Activities," *Foundation for Defense of Democracies*, February 14, 2020. (https://www.fdd.org/analysis/2020/02/14/uns-new-anti-israel-blacklist-condemns-companies-for-generic-business-activities)

**31.** "Who Profits," *NGO Monitor*, June 28, 2022. (https://www.ngo-monitor.org/ngos/who_profits)

**32.** 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)

**33.** Clifford May, "Human Rights Watch Crosses the Line with latest Attack on Israel," *Washington Times*, May 4, 2021. (https://www.washingtontimes.com/news/2021/may/4/human-rights-watch-crosses-the-line-with-latest-at); "Jewish Members Issue Statement Responding to Offensive Comments by Amnesty International USA's Executive Director," *Office of Congresswoman Lois Frankel*, March 14, 2022. (https://frankel.house.gov/news/documentsingle.aspx?DocumentID=3425)

The UN Human Rights Council, the UN Office of the High Commissioner for Human Rights, and Who Profits feature most prominently in controversy report summaries connected to Israel, including references to the UN blacklist. The reports frequently cite Human Rights Watch, while Amnesty remains a source used in connection with the Israeli-Palestinian conflict.

The Sustainalytics controversy report on Cellcom Israel, for example, claims the company faces reputational risk for its operations in Israeli-controlled territory because of Who Profits' reports, the UN Human Rights Office blacklist of 2020, and a letter issued by the UN Human Rights Council.

Sustainalytics also uses as references many organizations that have adopted BDS as a core line of effort. According to a list of sources provided by the company, those organizations include: Common Dreams, BankTrack, CorpWatch, DanWatch, Friends of Al Aqsa, Global Research, IMEMC News (a project of If Americans Knew), the Israel/Palestine Mission Network of the Presbyterian Church (USA), the Presbyterian Church (USA) itself, Sum of Us, War on Want, the International Federation for Human Rights (FIDH), New England Conference of the United Methodist Church, the Centre for Research on Multinational Corporations (SOMO), the Scottish Palestine Solidarity Campaign, and Norwegian People's Aid.

Common Dreams, for example, appears as a source in Motorola Solutions' controversy report with the headline "Brown University agrees to divest from company linked to abuses." Sustainalytics' "Incident Details" of the article states, "Brown University's Advisory Committee on Corporate Responsibility in Investment Policies (ACCRIP) voted in favor of divesting from companies involved in human rights abuses against Palestinians in West Bank and Gaza," though a later update adds at the end, "Brown University did not formally divest from the company yet."

Sustainalytics also uses anti-Israel and far-left "news" outlets, including Klassekampen (Norway), Krapuul (Netherlands), Ma'an News, Middle East Monitor, Electronic Intifada, Mondoweiss, Morning Star (UK), Palestine Monitor, Palestine News Network, and Voxy (New Zealand).

Other news sources come from authoritarian regimes, including Xinhua (China), Russia Today, and Interfax (Russia).

The White & Case report revealed that Morningstar Sustainalytics had recently established a prohibited source list to ban the use of sources overtly biased against Israel — and that Sustainalytics had added Electronic Intifada, the Venezuelan regime-sponsored TelesurTv.net, and the Iranian regime-sponsored Iran Daily to that list. All three, however, remain on the source list provided by Sustainalytics.

Morningstar's October 31 announcement restricted the use of the UN Human Rights Council as a research source and suspended the use of Who Profits. No other problematic source was referenced in the announcement nor did the statement address how the company would handle sources that either report on or derive assumptions from newly restricted or suspended sources. Mainstream news outlets regularly report on actions taken by the UN Human Rights Council while anti-Israel NGOs use the Council's assumptions as the basis for targeting Israel-connected companies. The decision to suspend rather than restrict Who Profits raises additional concerns given the unique relationship between Sustainalytics and Who Profits revealed in the White & Case report.

## So-Called 'Engagements' with Companies

### Case Study #1: Motorola Solutions

Sustainalytics currently lists Motorola Solutions in a "disengage" status on its Global Standards Engagement database. The GSE case summary for Sustainalytics' engagement with Motorola Solutions cites the company's provision of surveillance technology that Israel employs as part of its security barrier. Sustainalytics claims the barrier "raises serious human rights concerns as it negatively affects Palestinians' economic and social rights," even though "Israel stressed that the purpose of the wall was to prevent terrorist attacks and improve security." Sustainalytics then references the UN blacklist, observing that Motorola Solutions' "ongoing involvement was confirmed in February 2020, when the UN OHCHR, in its database of companies involved in activities that raise particular concern over human rights violations in the OPT, listed Motorola and Motorola Israel as involved in the supply of surveillance and identification equipment for settlements, the wall and checkpoints."[34]

Email correspondence going back more than a decade makes clear that Sustainalytics knows full well that listing a company in a "disengage" status is a signal for clients to divest. In a September 21, 2011, email to Motorola Solutions, GES states that it "recommends its clients to engage with Motorola, or as an alternative, to exclude the company from the investment universe."[35] After years of Motorola Solutions making clear that it would continue to support Israel's defense needs and that Israel's actions did not constitute violations of human rights, GES threatened in a September 16, 2016, email, "GES may recommend its clients to disengage, and this in turn may result in investors withdrawing from the company. Hence, to avoid Motorola Solutions being excluded from portfolios, we very strongly urge you to start addressing investor concerns again."[36]

Correspondence with Motorola Solutions has continued since the acquisition of GES, with the most recent request for "dialogue" sent in August 2022.[37]

On its face, Sustainalytics' GSE service is actively engaged in boycott Israel activities — inflicting economic harm on an Illinois-based American company (Motorola Solutions) due to the location of its operations in territories controlled by Israel and the nature of its support to Israel's defense despite the company's compliance with U.S. and Israeli law.

### Case Study #2: Elbit Systems

The GSE case summary for the Sustainalytics engagement with Elbit Systems cites the firm's provision of an electronic detection fence system for Israel's security barrier, development of a tunnel detection system used around Gaza, and the supply of arms to the Israeli military as key areas where it is violating human rights. The full summary disregards Israel's right to defend itself against terrorism — even deriding the development of a tunnel detection system used around the Gaza Strip to stop Hamas terrorists from infiltrating Israel — and falsely suggests that Israel targets civilians during conflicts with the Hamas terrorist organization.

**34.** "SUSTAINALYTICS GLOBAL STANDARDS ENGAGEMENT - Motorola Solutions, Inc," *Morningstar Sustainalytics,* accessed November 16, 2022. (https://globalaccess.sustainalytics.com)
**35.** "SUSTAINALYTICS ENGAGEMENT DIALOGUE REPORT - Motorola Solutions, Inc," *Morningstar Sustainalytics,* accessed November 16, 2022. (https://globalaccess.sustainalytics.com)
**36.** Ibid.
**37.** Ibid.

In its GSE report, Sustainalytics reveals attempts to coerce Elbit Systems to stop engaging in economic activity that supports Israel's efforts to defend itself. The report states:

> Sustainalytics has tried since 2009 through email, phone calls, letters and setting up a meeting with investors at the company's headquarters in Israel to establish a dialogue with both the IR department and the company's management, including the CFO and Executive Vice President … In October 2017 Sustainalytics met with representatives of the Israeli Ministry of Strategic Affairs and the Israeli Ministry of Foreign Relations.[38]

According to Sustainalytics' Dialogue Summary, "Sustainalytics decided in June 2013 to disengage from the company."[39] Indeed, Elbit Systems' GSE case status remains "disengage" today. On its face, this appears to be a harmless state of merely halting contact with the company. But emails contained in the company's Engagement Dialogue Report reveal a much different explanation.

An email sent to Elbit Systems on June 17, 2013 — which aligns with the date referenced in the Dialogue Summary — stated, "Since it has been confirmed that Elbit Systems still has operations considered a breach of above mentioned guidelines and norms we are from today, 17 June 2013, recommending investors to exclude your company from their investment universe rather than actively engaging with you, which is what we always prefer."[40] Emails sent to Elbit Systems over several years repeat this language.

An email sent on June 29, 2016, stated, "I am emailing you to remind you of the fact that GES*, due to lack of response and progress, is still recommending investors to exclude Elbit Systems from their investment universe, as has been communicated to you in June 2013."[41] The author found no evidence that this exclusion recommendation was ever lifted.

Correspondence with Elbit Systems has continued since the acquisition of GES, with the most recent request for "dialogue" sent in August 2022. Records show Sustainalytics and Elbit Systems held a conference call on September 20, 2022, but the engagement status did not change.[42]

On its face, Sustainalytics' Global Standards Engagement service is actively engaged in boycott Israel activities — inflicting economic harm on an Israeli company (Elbit Systems) due to the location of its operations and the nature of its support to Israel's defense.

### Impact of October 31 Announcement

These concerns could be alleviated by the October 31 announcement if Sustainalytics removes these and other relevant companies from its GSS watchlists, closes all such GSE engagements and removes any "disengage" status from the companies. Noting that Sustainalytics maintains past engagement correspondence with other Israel-connected companies subject to ongoing controversy ratings (e.g., Israeli banks), which can be reviewed by investors on Global Access despite their "archived" status, as Sustainalytics removes controversies pursuant to the October 31 announcement, it should also remove past engagement correspondence as well.

**38.** "SUSTAINALYTICS GLOBAL STANDARDS ENGAGEMENT - Elbit Systems Ltd," *Morningstar Sustainalytics,* accessed November 16, 2022. (https://globalaccess.sustainalytics.com)
**39.** Ibid.
**40.** "SUSTAINALYTICS ENGAGEMENT DIALOGUE REPORT - Elbit Systems Ltd," *Morningstar Sustainalytics,* accessed November 16, 2022. (https://globalaccess.sustainalytics.com)
**41.** Ibid.
**42.** Ibid.

## Citing Possible Clients Engaged in BDS Divestment Campaigns

Morningstar Sustainalytics often cites decisions by foreign investment funds to boycott Israel-connected companies as proof that those companies pose increased risks to investors. Some examples include:

- "KLP's divestment of Motorola presents financial impacts for the company and reputational and financial risks of other institutional investors following suit."[43]
- "KLP's divestment of Bezeq presents financial impacts for the company and reputational and financial risks of other institutional investors following suit."[44]
- "Dutch, Danish, New Zealand, and Nordic pension and superannuation funds decided to divest from Bank Leumi, citing that the bank's involvement is "illegal under international humanitarian law" and inconsistent with the UN Global Compact."[45]
- "Since 2014, two pension funds, PGGM and FDC, have decided to divest from Bank [Hapoalim], citing concerns that the bank's financing of settlements in the territory is 'illegal under international humanitarian law.' In July 2020, Dutch pension fund ABP also stopped investments in the bank followed by Scotland's Lothian Pension Fund in June 2021 and Nordic pension fund KLP in July 2021."[46]

Sustainalytics acknowledged that some of the institutions listed as divesting from Israeli companies (further justifying the companies' higher risk ratings) are clients of Sustainalytics, but did not detail which firms are its clients. In effect, Sustainalytics both delivers negative ratings to clients about Israel-connected firms and cites those clients' divestments as evidence of controversy that poses a risk to other firms. Sustainalytics controversy reports do not disclose these client relationships.

Morningstar's October 31 announcement may alleviate these concerns by removing references to these divestment campaigns from its controversy reports and precluding them as a factor in controversy scoring.

**43.** "Sustainalytics Controversy Report - Motorola Solutions, Inc," *Morningstar Sustainalytics,* accessed November 16, 2022. (https://globalaccess.sustainalytics.com)
**44.** "Sustainalytics Controversy Report - Bezeq The Israeli Telecommunication Corp. Ltd," *Morningstar Sustainalytics,* accessed November 16, 2022. (https://globalaccess.sustainalytics.com)
**45.** "Sustainalytics Controversy Report - Bank Leumi Le-Israel Ltd," *Morningstar Sustainalytics,* accessed November 16, 2022. (https://globalaccess.sustainalytics.com)
**46.** "Sustainalytics Controversy Report Bank Hapoalim BM," *Morningstar Sustainalytics,* accessed November 16, 2022. (https://globalaccess.sustainalytics.com)

## Conclusion

A key question for states with anti-BDS laws is whether there is evidence that Morningstar Sustainalytics has attempted to penalize or inflict economic harm on companies based in or operating in Israel or territories controlled by Israel. As of today, the answer appears to be yes. On the basis of location alone, Morningstar Sustainalytics raises companies' ESG Risk Ratings, assigns Significant and High controversy scores, adds companies to watchlists intended to lead to divestment, and uses so-called "engagements" to implicitly threaten to encourage divestment unless companies end their business operations in territories controlled by Israel.

Up until the October 31 announcement, Morningstar's primary defense remained the report it commissioned from White & Case, which, despite substantial evidence to the contrary, concluded that Sustainalytics had no systemic bias against Israel and did not discourage investment in Israel-connected companies. Putting aside the fact that Morningstar paid for the White & Case report and that FDD has disputed White & Case's conclusions using the facts presented in its own report, recent media revelations about White & Case's sponsorship of two events featuring an anti-Israel speaker who called Israel an apartheid state further calls in to question Morningstar's reliance on White & Case.[47]

Morningstar's October 31 public statement may represent the first step in rooting out the systemic bias against Israel identified in this report. Changes to assumptions and sources could lead to the removal of controversies, watchlisting and engagements for Israel-connected companies — and could lead to the restriction of all anti-Israel sources currently used for ESG ratings.

While this research memorandum focuses exclusively on Morningstar Sustainalytics' ESG ratings, this kind of systemic bias against Israel may exist inside other providers of ESG research and ratings. Investors should not only demand fundamental change at Morningstar but ask other firms to discuss their practices related to controversies connected to the Israeli-Palestinian conflict and the BDS campaign.

**47.** Richard Goldberg, "How to Curb Anti-Israel Bias Inside ESG Risk Ratings," *Foundation for Defense of Democracies*, June 17, 2022. (https://www.fdd.org/analysis/2022/06/17/how-to-curb-anti-israel-bias-inside-esg-risk-ratings); Mike Wagenheim, "Israel 'Apartheid' Event Sponsored by Law Firm that Exonerated Morningstar of Anti-Israel Bias," *Jewish News Syndicate*, October 16, 2022. (https://www.jns.org/israel-apartheid-event-sponsored-by-law-firm-that-exonerated-morningstar-of-anti-israel-bias);"White & Case law Firm Distances Itself from Second Anti-Israel Event in a Week," *The Washington Free Beacon*, October 20, 2022. (https://freebeacon.com/latest-news/white-case-law-firm-distances-itself-from-second-anti-israel-event-in-a-week)

## 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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