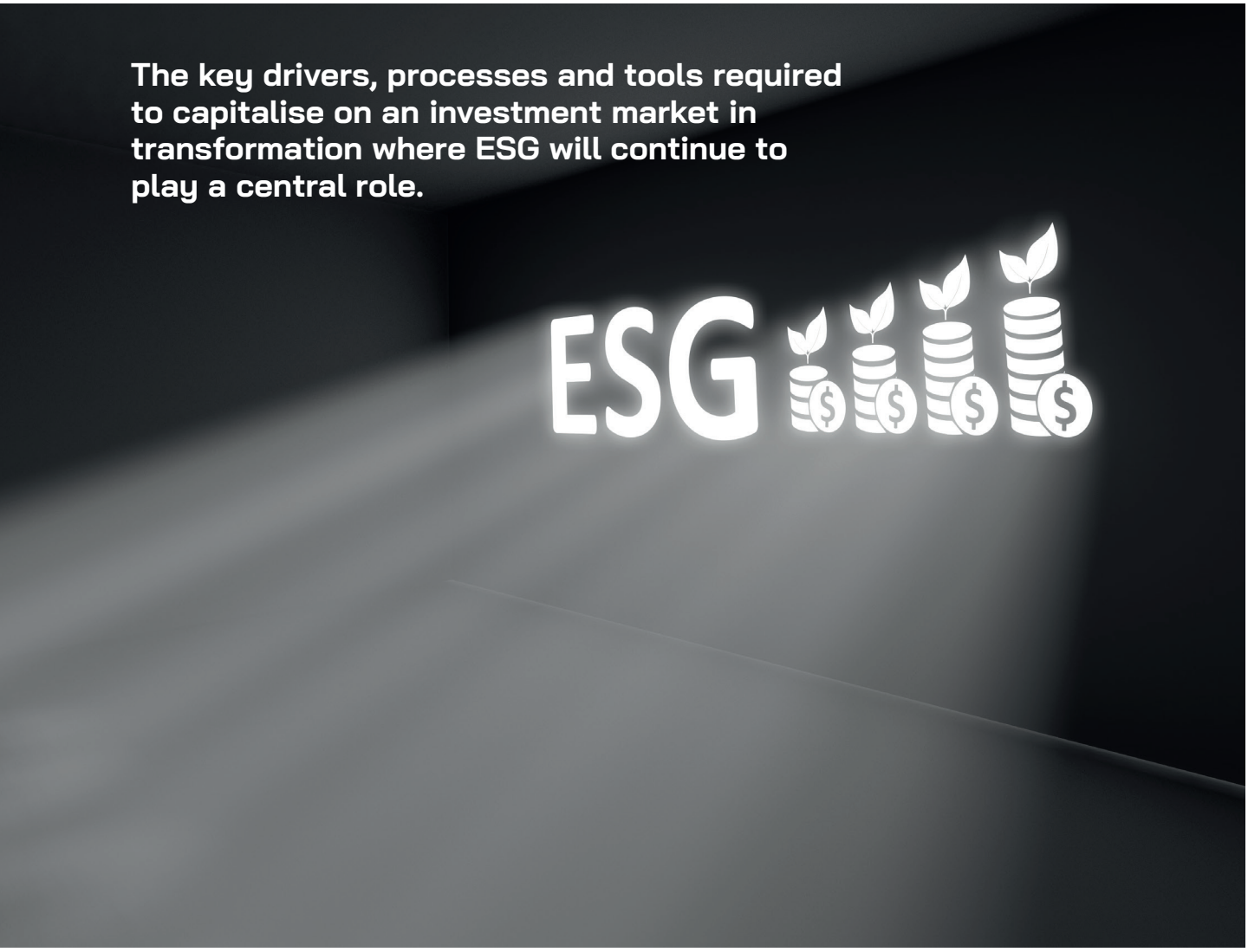
Effective ESG investing
Why the end-to-end approach is gaining ground

The key drivers, processes and tools required to capitalise on an investment market in transformation where ESG will continue to play a central role.



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Successful ESG investments require more than just a new mindset. The pressure on institutional investors to include ESG factors in their investment decision-making processes is growing exponentially. Regulatory changes and growing stakeholder activism are placing sustainability at the top of asset managers' and asset owners' agendas.

There is increasing academic evidence of the correlation between successfully embedding material ESG information into the fund offering and delivering high returns. Whether this materialises or not, the evidence on the ground is that inflows to ESG funds are growing exponentially.

At a minimum, ESG factors have become mainstream in investment research. It would be a great mistake not to assess the risk that your investments face from climate change as well as the risks that they pose to it.

Those firms that have mastered the complex task of navigating uncertain market conditions, reducing costs and responding to regulatory pressures are one step ahead.

Combining all of this and adding a tailored investment experience that leverages behavioural analytics and digital platforms, results in true differentiation.

What do end-investors want?

Investors' appetite for high returns has not abated but strong outcomes now need to be combined with sustainability demands. Indeed, reputation is now competing with return and risk considerations in ESG investing even for the most conservative of institutions. Firms that want to stay competitive and attract new business and talent are expected to prove that they are taking net-zero and other ESG commitments seriously across their whole portfolios.

However, it is not sufficient to simply make net-zero carbon emission promises. Because of growing concerns around "green washing", end-investors expect companies to demonstrate they are sticking to their ESG mandates. As such, they want evidence of ESG compliance, reporting and transparency.

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Ultimately, this means fully integrating ESG considerations across strategies and processes with consistent data across investments and full reporting.

However, deciding on an ESG strategy and demonstrating credentials is far from straightforward, as different investors may have different priorities. For instance, some firms are focused on climate while others are looking at social and governance. Within many ESG themes, data and analytics may be thin on the ground.

This subjectivity around ESG priorities is also reflected in the wide variation in ESG scores from different data vendors, ratings agencies, and research providers.

Buy-side firms have been dealing with growing volumes and increased complexity of data for a while now, which is compounded by the need to integrate disparate ESG metrics from multiple external sources. This is posing the greatest data management challenge to date. It is costly, complicated and time-consuming but more importantly, it distracts from the core business.

To overcome this, it will be critical to select the right technology partner who can provide consistent ESG data across all assets, ensuring these insights are seamlessly integrated across end-to-end investment lifecycle. This includes a robust ESG reporting

framework that delivers accurate and timely ESG data to investors, regulators and other stakeholders.

The ESG data puzzle

One of the biggest challenges stems from a lack of data standardisation and the inability to feed non-standardised ESG data into investment operations. ESG data is unique and has its own taxonomy. Because most companies are not subject to mandatory reporting, the onus is on fund operators to manage ESG data that, contrary to traditional financial datasets, tend to capture intangible factors which could materially impact an issuer's future performance.

Added complexity comes from the lack of consistency, comparability and the myriad of data vendors with their own scoring methodologies, sources and coverage. Data suitability and the lack of real-time information in legacy/fragmented systems prevalent today further limits the move towards ESG transparency.

"In the past few years, ESG investing has evolved from simple screening and exclusion principles to more sophisticated approaches that include all asset classes, across public and private markets."

In the absence of mandatory disclosure requirements by buy-side firms, some data providers also fill gaps with proxy data which may further distort ESG assessments. Faced with the herculean task of standardising all the different categorisations of ESG data, many investment managers are turning to manual processes. From acquisition to normalisation, cleansing and reporting, investment managers are arduously piecing together this patchwork of unstructured data in various formats with the goal of understanding their impact on sustainability and making the right decisions.

However, this non-standardised data and the manual and error-prone workflows associated with it means that the insights gained are questionable. Yet, faced with the current imperfect market information, managers will continue to use several third-party ESG data providers to complement their own analysis.

Fortunately, there is another way of safeguarding these insights without having to go through the trouble of acquiring and managing the data yourself—Data as a Service.

Upgrading Investment Management capabilities

The first step to successful ESG investing is access to reliable data—a process that is costly and often requires a lot of monitoring and manual work. Changing vendor data models over time and maintaining acquisition feeds and integrations are creating a drag, taking already scarce resources away from delivering investment returns and risk management.

ESG data sourcing and management

ESG is the perfect use case for Data as a Service (DaaS). Fund operators can benefit from a wide variety of data sources, without the hassle and risk of collecting and processing data internally. DaaS does this by fully automating the in-bound ESG data received from a multiplicity of parties, ensuring its validity and creating a single source of truth for the entire organisation.

At its core, this managed data service enables investment managers to retain 100% control of their data, proprietary insights and governance, while taking the operational burden out of the process. Not only does this provide accurate, consistent ad reliable data throughout the organisation, it also frees up internal resources to focus on value-add, differentiating activities.

Moreover, these services do not just add transparency, they also provide a specialist advisory service through industry experts. This can help investment managers navigate and implement future regulations, including the looming SFDR deadline in 2022.

By leveraging a data-driven approach to ESG investing, where one source of reliable truth acts as a solid foundation for the whole organisation, data teams are effectively freed up from manual processing tasks, and firms can instead focus their tie on creating proprietary insights from validated ESG data. They can then reliably act on these insights and enhance their ESG offerings to retain and attract new clients.

ESG data processing throughout the investment lifecycle

Getting data into the system is just the first part of the journey. It must then be robustly managed and governed, and optimally processed across the entire investment value chain. Key to this process is the consolidation of ESG

data and analytics into the core investment data set and across the investment lifecycle front-to-back.

Clearly, ESG investing is not something that can be done in silos. It must be integrated into the core investment process with rigorously applied investment analysis and optimisation as well as sophisticated compliance and risk management. Only then can investment managers act with accuracy and agility to capture new market opportunities.

One sign that the industry is moving in this direction and that investment approaches are maturing is the shift away from negative screening as the foremost approach to ESG. Instead of excluding companies and sectors from their strategies, institutional investors are now including ESG factors in their analysis and decisions to better manage risks and improve returns.

This is good news. It means that despite once being treated as a standalone function within the business, ESG is now being embedded throughout organisations with integration methods growing in sophistication.

In the long run, all investment managers will be expected to embrace this trend with responsible factors considered across all investment offerings, not just those specifically designed as ESG products.

As ESG data and analytics are increasingly used for measuring systemic risk and predicting financial performance alongside the more traditional financial data, they will have to be available to a far broader set of people within the organisation.

Ultimately, expertise and knowledge need to be readily available to portfolio managers across all asset classes and products. That means ESG analytics must be integrated with other data metrics in a common Investment Book of Record to achieve a holistic view across all instruments.

Having access to real-time positions, performance, and risk analytics as well as sophisticated pre- and post-trade compliance enables a robust and outcome-driven approach to ESG investment strategies.

"Operations platforms need to facilitate the larger scale and the additional complexity in both data and analytics that is required for investment managers to achieve their sustainability-related targets, and to future proof the infrastructure to cater for the fast-evolving ESG market and regulation. At the same time, it is essential to maintain unbreakable consistency and integrity in areas such as trade controls, which is key to maintain trust and legitimacy within ESG Investing. These are the reasons we have evolved our single-platform approach to include ESG analytics," said Carl Balslev Clausen, ESG Offer Manager, SimCorp.

ESG reporting

Today, clients want to be informed of the impact of their investments. They are demanding communications that are timely, transparent, accurate and credibly show that the investment manager is delivering the ESG promise.

Meeting this growing client need for reporting on ESG factors requires a strategic approach to communication. Firms need an automated, workflow-driven client reporting platform with seamless integration of all the required ESG data sources.

The ability to flex and pivot those data sources as they become available or as regulations change in order to inform clients in the most relevant and timely manner will be the key differentiator.

Given the fragmented nature of investment processes prevalent today without a holistic view of all asset classes, many organisations still rely on ESG data for specific products rather than ensuring it is used enterprise wide.

This lack of cross-referencing of ESG datasets with those in the investment lifecycle, means data from multiple systems must be manually pieced together to generate ESG insights at the portfolio level.

This introduces a number of inefficiencies, weakens data governance, and limits scalability in the reporting process—not to mention the inability to tailor the prioritisation of different ESG factors within the reports, the real value-add for clients.

Firms that are determined to retain and win more business are securing a reporting platform that treats ESG data the same way as all other financial data and embeds it properly within the client reporting communications processes for a much more comprehensive picture.

They are also going one step further by offering not only the flexibility to customise reports in different layout and formats but also the ability to extract and select ESG factors for their client's own analysis.

Firms that fail to address the demands for greater client experience and transparency could simply lose market share to other service providers.

Delivering a differentiated investment experience.

There is no one single correct way to invest in ESG. There are multiple ESG strategies with different objectives and purposes that provide a myriad of portfolio construction possibilities.

However, despite the wide range of approaches, one thing is clear: incorporation of ESG factors across the entire investment process is critical. Fund operators must be able to capture the full impact of ESG metrics on investment decisions, compliance, performance attribution and risk. Consistency and innovation are key.

Once an ESG strategy has been adopted, investment managers must ensure that it is applied consistently across all business areas—from the chosen data sets to the communications with end-investors. Only then can firms provide the transparency that clients need and confidently show their commitment to the ESG strategy.

In order to achieve that ultimate objective, firms must carefully choose a technology partner with a platform that allows ESG integration front-to-back in a single system which also offers the optionality to outsource non-core operations, such as Data as a Service.

Forward-looking firms will also seek partners with open platforms that offer them the ability to tap into innovative fintech technologies that create enriched perspectives on ESG and impact.

As the ESG investment landscape evolves, savvy managers that have invested in an open system and flexible framework that can adapt quickly to combine ESG with high returns, new regulations and changing demands from their investors, will leap ahead. ■