COP26:
DATA PROVISION KEY FOR ASSET MANAGERS

29 November 2021

Overview

What should investors make of COP26? For me it was a mix of hope and frustration. It is true to say that the agreement did not go far enough to limit the temperature rise to anywhere near 1.5 degrees.

However, some concrete milestones were achieved such as the pledges to 'phase down' coal, cut-down methane emissions and reduce deforestation, and the advancement of a rule book for a global carbon market.

During the COP 26 weeks, an adjacent announcement was also welcome: the creation of the International Sustainability Standards Board (ISSB).

It may not seem the most exciting measure but it could be a real game-changer over time as it would create a formal transparent accounting link between ESG and financial reporting for companies.

The Board, which will be a sister body to the International Accounting Standards Board, is being established to come up with reliable and comparable reporting by companies on climate and other ESG issues.

This is an area of great importance to our industry as we seek to influence companies – the better the information we have, the more we can collectively agitate for change.

ESG data – sadly lacking

Unlike economic or financial data, which is standardised and provided regularly, ESG data is slow moving and lacks standardisation: investors are largely reliant on information published by companies themselves with few common norms.

Using external ratings is not a solution either. While ESG ratings have proliferated, there is a relatively high level of dispersion with various methodologies used to judge ESG, with different measurements and weights.

There is no correlation between ratings because there is no common approach to how E, S and G are interpreted, scored and weighted. This makes ESG investing particularly difficult to navigate as, depending on which ratings company is used, the result can be quite different. Our approach is therefore to treat ESG ratings from external sources more like analyst opinions.

Impact data is even worse – it is unstructured and often more qualitative and judgmental than data for ESG. For example, it is currently difficult to quantify how a company compares against the UN's 17 Sustainable Development Goals. Much more information is required for fund managers to make proper assessments.

Fiona Frick
Group Chief Executive
Unigestion

Key Points

1. COP26 was a mix of hope and frustration
2. The creation of the International Sustainability Standards Board was welcome and a potential game changer
3. The better our data is; the more we can agitate for change

Taking control of the data

In that context, we have taken the issue of ESG scoring into our own hands. Our proprietary ESG computing methodology provides a comprehensive measure of companies' progress using indicators from external providers and distinguishing between the materiality of different indicators and issues for companies at the subindustry level. We then apply our internal weighting and finally, accommodate the impact of fast-evolving controversies, as well as their severity, by penalising the overall ESG score. We have a similar methodology for country-level ESG scores. This creates a coherent framework for corporates and countries, which is then reflected in the equity and the bonds we buy.

With regard to private assets, the situation is different again as external data is scarce. Our private equity team accesses data directly through discussion with portfolio companies, enabling them to evaluate ESG scores and SDG performance indicators for different companies based on our research.

The emergence of big data

More alternative and high frequency (big) data is now emerging to assess ESG risk with less of a time-lag. This is an advantage for active managers that can use technology to integrate this alternative source of information in their assessments. The challenge is to transform the unstructured information into valuable investment insights - technology platforms will play a big role in this.

We use natural language processing (NLP) to gain advantage. By screening posts on social media, press articles and declarations from NGOs, we can spot controversies before they are reflected in ESG ratings. Some players in the fintech space are also developing capabilities in this field and we are collaborating with them to better understand the sustainable impact of companies we invest in.

Our platform can compound and deal with different ESG databases comprising structured and unstructured data and we implement some NLP capabilities to transform data into an ESG sentiment score. It also enables us to find some investment ideas in companies that are rated positively with regard to their ESG journey.

While the ISSB will start work to standardise disclosures during 2022 and metrics will continue to improve, this will take time. In the meantime, active asset managers, particularly those who employ technology to assess and exploit information accurately, have an advantage.

Better data enables our industry to reward and allocate capital to companies adapting to the requirements of a sustainable economy, while upping the pressure on those who don't. Capital allocation linked to technology transparency can collectively contribute to drive the change COP 26 has stimulated.

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