The thorny issue of managing ESG data

Given the lack of standardised metrics and ratings, it is important for investment managers to first identify the purpose for which their data will be used. **By Kok Kah Fai**

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WITH demand higher than ever for Environmental, Social and Governance (ESG) products, investment managers are competing at a fierce pace both to innovate with new products and to integrate ESG screening into existing funds. And ESG data can deliver important insights into risks and potential of investment opportunities, and will therefore continue to evolve as an integral component of the investment decision framework.

Within the framework, the first requirement for investment managers is to identify their ESG data use cases. Will the data be used to profile risk, for example, or identify alpha? Or will the data help drive environmental engagement and stewardship with corporates? Clarity is important because each purpose requires its own approach to data analysis and impact output.

The challenges of ESG data management

Next comes the thorny issue of managing ESG content. Without sufficient planning, investment managers risk being blindsided by subsequent operational support requirements. There is a need to manage raw ESG data, which brings with it challenges around content and the interpretation of the data.

Perhaps the most pressing challenge is the lack of standardisation of E, S, and G factors, and the wide variances in ESG metrics between industries and markets.

ESG data is an extremely varied dataset, with leading providers covering various aspects, such as ratings, self-disclosed ESG-related information and subjective assessments. Firms need to be able to collate and map ESG data across their comprehensive investible issuer and securities universe. Doing so provides the broadest possible view when firms implement and monitor portfolio decisions, in part because ample, a holding in a solar energy company may be far less green than it appears if that company is owned by an oil producer.

But even for the more "straightforward" ESG ratings, it has been well demonstrated that given the lack of standardised metrics and ratings, methodology divergence can result in a single security being rated very differently according to each data provider. Sourcing the appropriate ratings, or even an optimal combination of datasets from different ESG specialists for the maintenance of internal ESG ratings, reflective of institutional ESG philosophy, can be a lengthy and time-consuming process.

Specific considerations

Sourcing/acquisition: From the outset, firms need to understand and compare the different data elements available from providers. These could be as "simple" as ESG ratings, specific carbon related data, or even fundamental data.

It is essential to source relevant datasets from leading providers, as well as to set up necessary trials to understand and compare the quality of the data. To execute this properly, it's necessary to staff an expert team with sufficient resources. This sourcing/acquisition phase is always "live" given the inevitably dynamic set of business requirements – it's therefore necessary to consider this as a "business-as-usual" process.

Cross-referencing: A huge field of material is being harvested by a wide range of providers, many with insights into specific company types, sectors, environments and social or political trends. Each provider might present the data in its own unique way. The result is that institutions are faced with a mountain of non-harmonised data. Attempting the necessary analysis is hampered by a lack of mapping or cross-referencing across data sets via LEI (Legal Entity

ESG data need to be managed better moving forward, avoiding the current pervasive practice of maintaining disjointed sets of ESG data, with different entities and securities identifiers. This challenge should be addressed holistically, and properly thought through – especially at this stage, where there are minimum legacy issues.

the ability to compare data sets, look for pa terns or create rule-based hierarchies. This co sideration needs to be thought through car fully upfront.

Agility: ESG data selection is driven by bu ness requirements, which are fundamentally d namic and, more often than not, urgent. To he businesses make timely ESG decisions, data o erations must be set up to minimise bottl necks. A solution, by definition, must be able accommodate rapid mapping, enrichment ar scoring across the institution's specified mul asset universe of interest. It is also importa that firms are able to adapt their strategy ar product to meet client demands, and that t data management model can support this flexi ility.

Platform: Firms should adopt a platfor based approach to ESG data management in o der to enable more effective quality assuranc customisation, aggregation and downstrea "fit-for-purpose" formatting. Increasingly, th data should also be made available via APIs su as Python, MatLab and R or through customis feed formats, so that it's easy to integrate in ad-hoc processes.

Compliance: When designing a data manag ment model for ESG, firms also need to consid best execution requirements, as well as how ensure compliance with emerging regulatio such as the EU's Sustainable Finance Disclosu Regulation (SFDR). Sourcing, mapping and vali ating high-quality data are once again essenti considerations.

Deployment options

ESG data needs to be managed better moving fo ward, avoiding the current pervasive practice maintaining disjointed sets of ESG data, with d ferent entities and securities identifiers. should be clear now that ESG data manageme does not "just happen". This challenge shou be addressed holistically, and properly thoug through – especially at this stage, where the are minimum legacy issues.

Possible solutions ranges from building u an in-house capability to going on to a fully ma aged data service. There is also a midd ground, in which in-house experts govern pr cesses, while operations are managed by str tegic partners. These external data manageme specialists can minimise the implementatio risk through a combination of scalable platfor established access to multiple ESG data source in-house ESG data experts as well as operation processes to enable accelerated time-to-mark

It is reasonable to expect that ESG data se will continue to grow in complexity, with pote tially more data sources, available in multip formats, as well as driven by evolving busine requirements. Evolving practices around self-i dexing and the emergence of ESG-focused secu ities services will add further complexity. If a only if an institution is fully prepared with a w thought out and scalable approach to handli ESG data, will it be able to minimise any pote tial issues in its future growth.

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