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# The Need for ESG Harmonization and Convergence

By Eugeniu Guzun – HedgeNordic

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Despite unprecedented growth driven by strong investor demand and net zero commitments, ESG investment remains a much-debated and often controversial topic. With policy-makers strengthening rules around sustainability disclosures, asset managers are focusing their efforts on complying with the new guidelines, yet it is still difficult for investors to compare relevant ESG information to make informed decisions.

## DATA-ENABLED ESG ASSESSMENT

HedgeNordic sat down with Frank Talsma, Head of Data and Risk & Investment Analytics, responsible for ESG product development, and Iida Pöyliö, Senior Associate, Client Coverage, Nordics at RBC Investor & Treasury Services (RBC I&TS) to discuss the current state of ESG investment in alternative asset classes, particularly in the Nordic region. One tectonic shift within the ESG arena observed by both Frank Talsma and Iida Pöyliö is the transition from a mainly subjective judgment-oriented assessment of ESG performance to a data-enabled one.

"In the past, Nordic investors such as government entities tended to make feelings-based or subjective judgment-based decisions when assessing one's ESG engagement," observes Iida Pöyliö. "Investors want to make well-informed decisions, which requires more data and transparent and reliable reporting from asset managers," she continues. The challenge that asset managers face revolves around how and where to obtain the data to substantiate their ESG efforts. "This can become a differentiating factor when investors are evaluating asset managers' ESG strategies as well as their reporting capabilities," considers Pöyliö.

"Today if an asset manager wants to launch a new ESG-aligned product, it needs to meet high expectations," agrees Frank Talsma. "ESG investing often suffered from vague, poorly defined, and sentiment-based approaches. It needs to become much more fact-based and objective," he elaborates. "A lot of institutional money is looking to invest in ESG funds but the stakes are also high in the wake of greenwashing allegations and other issues," according to Talsma. "The key is to restore confidence in ESG investment products to satisfy the demand and continue the exceptional growth trajectory."

Although the tightening of regulation in the ESG space is presenting asset managers with new data and reporting challenges, these regulatory changes are also creating new opportunities. There are opportunities for asset managers to develop investment products that legitimately address ESG concerns and meet the demands of ESG-conscious investors. "There are challenges but there are also a lot of opportunities that have been accelerated by the recent wave of regulatory measures," confirms Talsma.

Consistent, verified and widely accepted data is crucial in the area of ESG investing, where a lack of mandatory and consistent reporting of non-financial information represents a key barrier to ESG integration. "ESG is an incredibly broad topic but I always start looking at it from a data perspective," says Talsma. "At the core, it's a data problem that needs to be addressed before we can solve other problems like reporting," he explains. There is actually an abundance of data, especially for liquid asset classes, that can be noisy, disjointed, incomplete, inconsistent, or poorly organized. Asset managers face the difficult task of obtaining relevant

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data across various asset classes that is of sufficient quality. "All of us, including ourselves, our clients, service providers, as well as regulators, are in a learn-by-doing approach. It is an enormous, interesting and very important experiment," concludes Talsma.

## REGULATORY EFFORTS

There are increasing regulatory and political efforts to bring more transparency to ESG investing and combat greenwashing to protect investors. "The regulators realized that it's a wild west out there and there is a need to create common rules for ESG investing and reporting," says Talsma. The European Union (EU) is at the forefront of ESG regulation with the introduction of the Sustainable Finance Disclosure Regulation (SFDR) back in 2021, which requires asset managers active in the EU to make detailed disclosures at both the product and entity level.

"We are now getting towards the tail end of the SFDR implementation with immense effort, especially over the last 12 months, to become more structured and better organized around sustainable investing," argues Talsma. This regulation has brought about new classifications, where investment products are labeled under either Article 6, 8, or 9 of the SFDR. "We have seen that this regulation created a push towards Article 8 (light green) and Article 9 (dark green) funds, which comes with several new reporting and governance requirements," elaborates Pöyliö.

Unsurprisingly, one of the big challenges of SFDR is data management and data quality, which is crucial in building representative disclosures. "Data is not going to be perfect and there will be gaps in reports such as the EET (European ESG Template), but this will improve over time," says Talsma. Firms need to clearly label their funds and define their products and strategies with ESG, preferably in an unambiguous language supported by the best and most appropriate data currently available, according to Talsma. "It is important to have the strategy and the tools in place to operationalize SFDR and wider ESG reporting for the future," adds Talsma.

"Approximately only five percent of client funds administered by us are classified as Article 9 and about 25 percent as Article 8 funds," observes Talsma. "The rest of the are Article 6 funds, which do not integrate any kind of sustainability into their investment process," adds Talsma. These figures show the challenge of meeting the Article 9 requirements. "However we are preparing to service a growing number of Article 9 funds over time as the industry is shaping up," argues Talsma.

A related landmark regulation is the EU Taxonomy, which sets out criteria for determining whether an economic activity is environmentally sustainable. "The EU Taxonomy provides a toolbox to help determine what a sustainable investment is," explains Talsma. He also observes that challenges around demonstrating taxonomy alignment have recently contributed to several Article 9 funds to downgrade to Article 8. "The taxonomy currently focuses on certain sectors, but in due time as the EU Taxonomy's objectives are finalized and more economic activities are added, this should contribute to the further proliferation of Article 9 funds," according to Talsma.

Finally, the Corporate Sustainability Reporting Directive (CSRD) is another important regulatory development that will set the standard by which EU companies will report on their climate and environmental impact. "The CSRD is going to be welcomed by the fund industry as corporates will report more detailed and harmonized sustainability data," explains Talsma. This will result in more easily accessible data, increased company accountability, as well as enhanced comparability.

## UTOPIA: UNIFIED ESG FRAMEWORK

The European Union is moving towards a roster of very comprehensive regulations that are often complex and difficult to implement at a practical level. Other parts of the world are taking similar yet different routes, but all have the same objectives in terms of accelerating the sustainability transition and combating greenwashing. "For investors wanting to make informed investment decisions, a unified framework with standardized and transparent ESG reporting is the holy grail," according to Talsma. "While current efforts led by regulatory and industry groups are promising, we all know that it will take time to fully get there," Talsma emphasizes. "Currently a global unified framework is a bit of a utopia," he adds.


Frank Talsma
Head of Data and Risk & Investment Analytics – RBC Investor & Treasury Services

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Talsma compares the evolution of ESG standards with the development of common accounting standards. "It took 20+ years of industry debate to get to common accounting standards. We are now dealing with something much broader and more complex, where regulation is just getting started, and where academic models are in their infancy and data sources are inconsistent and lack quality," says Talsma. "We cannot expect that a common standard will just drop out of the sky. It will take time, effort, and conviction."

"As a service provider to a broad spectrum of funds including ESG funds, we are well positioned in the industry ecosystem, both inside and outside the Nordics," says Pöyliö. This provides RBC with an excellent view of what is happening in the market around ESG investing and across the fund industry in general. "As a global service provider to our clients, we continue to keep them informed on the latest market insights and connect them to innovative solutions and approaches to support their requirements," adds Pöyliö. "We are here to support asset managers on their sustainable investment journey including those with specialized investment strategies where conventional approaches do not always work," she concludes.