ESG data:
Updates on an evolving regulatory and product landscape

Luke Wilcox

Partner, Head of Ethos ESG

ACA™

© 2022 ACA Group. All rights reserved.

About me

- Partner at ACA Group, leading ESG data and analytics
- Founded Ethos ESG, an ESG data and analytics software provider, in early 2019
- Worked with financial services and healthcare clients as a consultant with McKinsey & Company
- Led impact measurement and fundraising for nonprofit organizations

© 2022 ACA Group. All rights reserved.

Agenda

- Why ESG data is important for mutual fund directors
- Recent trends in ESG data
- Evolving regulation of ESG data
- Questions

© 2022 ACA Group. All rights reserved.

Why ESG data is important for mutual fund directors

- **Growth opportunities**: demand for ESG products and the amount of assets invested in ESG strategies continues to grow 20%+ YOY (*PwC*)
- **Conflicting investor pressures**: large segment of investors demanding increased reporting and transparency around ESG-labeled products and practices; other segments pushing against ESG integration
- **Emerging regulation and tightening circles of scrutiny**: increased regulatory frameworks and actions around ESG practices and use of data, especially in Europe and the US; focused on labeling, marketing and reporting
- **Increasing material ESG risk**: investors continue to recognize material risk from climate change and other ESG issues

© 2022 ACA Group. All rights reserved.

ESG investment and interest continues long-term growth path

Projected growth of global ESG AUM

$33.9T by 2026

PwC

$30T by 2030

Broadridge

$50T by 2025

Bloomberg

Interest in ESG or sustainable investments

8 of 10 US investors

Plan to increase allocations to ESG products *(PwC)*

99% US Millennials

Are interested in sustainable investing *(Morgan Stanley)*

75% institutional investors

Believe that ESG is part of their fiduciary duty *(PwC)*

ACA™ © 2022 ACA Group. All rights reserved.

What is typically included in “ESG data”?

Environment		
GHG emissions	Air quality	Energy management
Water management	Waste management	Ecological impacts
Materials sourcing	Physical impacts of climate change	Renewable energy
Supply chain management		

Social		
Human rights	Customer privacy	Data security
Access and affordability	Product quality and safety	Customer welfare
Selling practices	Labor practices	Employee health and safety
Engagement and inclusion	Racial justice	Equal pay
LGBTQ equality	Public health impact	Disease eradication

Governance		
Product design and lifecycle	Business model resilience	Business ethics
Competitive behavior	Regulatory management	Critical incident risk
Systematic risk	Executive pay	Board independence
Accounting	Tax	

Impact

© 2022 ACA Group. All rights reserved.

Sources: Sustainable Accounting Standards Board (SASB), Ethos

How ESG data is changing for mutual funds (recent trends)

1. Competing movements to standardize and customize
2. Growing reporting requirements
3. Investible universe expanding
4. Explosion of available providers and data types
5. Continued focus on climate; going deeper on climate data
6. Other areas continue to emerge (biodiversity, social issues)
7. Increasing availability for private markets, asset classes other than equities
8. Increased regulatory scrutiny
9. Significant potential of AI

ACA™ © 2022 ACA Group. All rights reserved.

2 Growing reporting requirements

Regulatory required	Regulatory voluntary	Investor-driven

California Climate Legislation

Proposed SEC Climate Rule

UK Sustainability Disclosure Requirements

EU Taxonomy

PRI Principles for Responsible Investment

GRI Empowering Sustainable Decisions

ESG INTEGRATED DISCLOSURE PROJECT

The Net Zero Asset Managers initiative

TCFD TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES

SASB SUSTAINABILITY ACCOUNTING STANDARDS BOARD

ESG Data Convergence Initiative

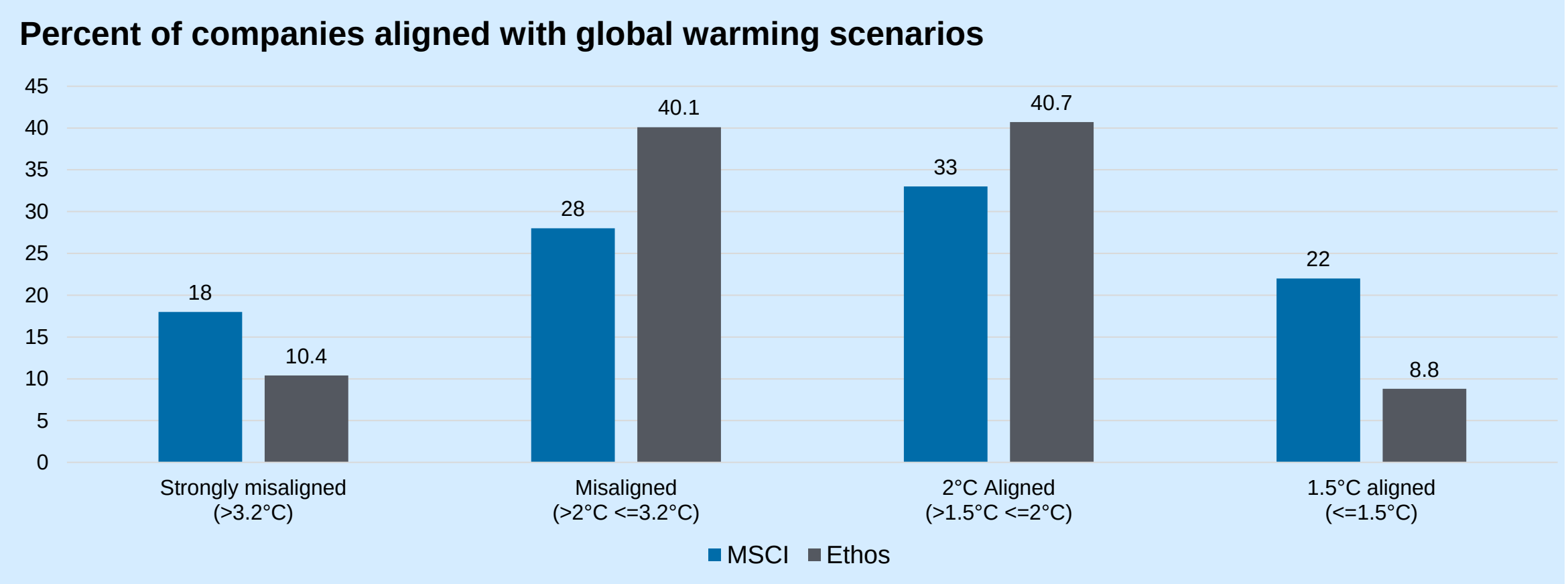
European ESG Template

GIIN GLOBAL IMPACT INVESTING NETWORK

ilpa INSTITUTIONAL LIMITED PARTNERS ASSOCIATION

ACA™ © 2022 ACA Group. All rights reserved.

3 Investible universe is expanding

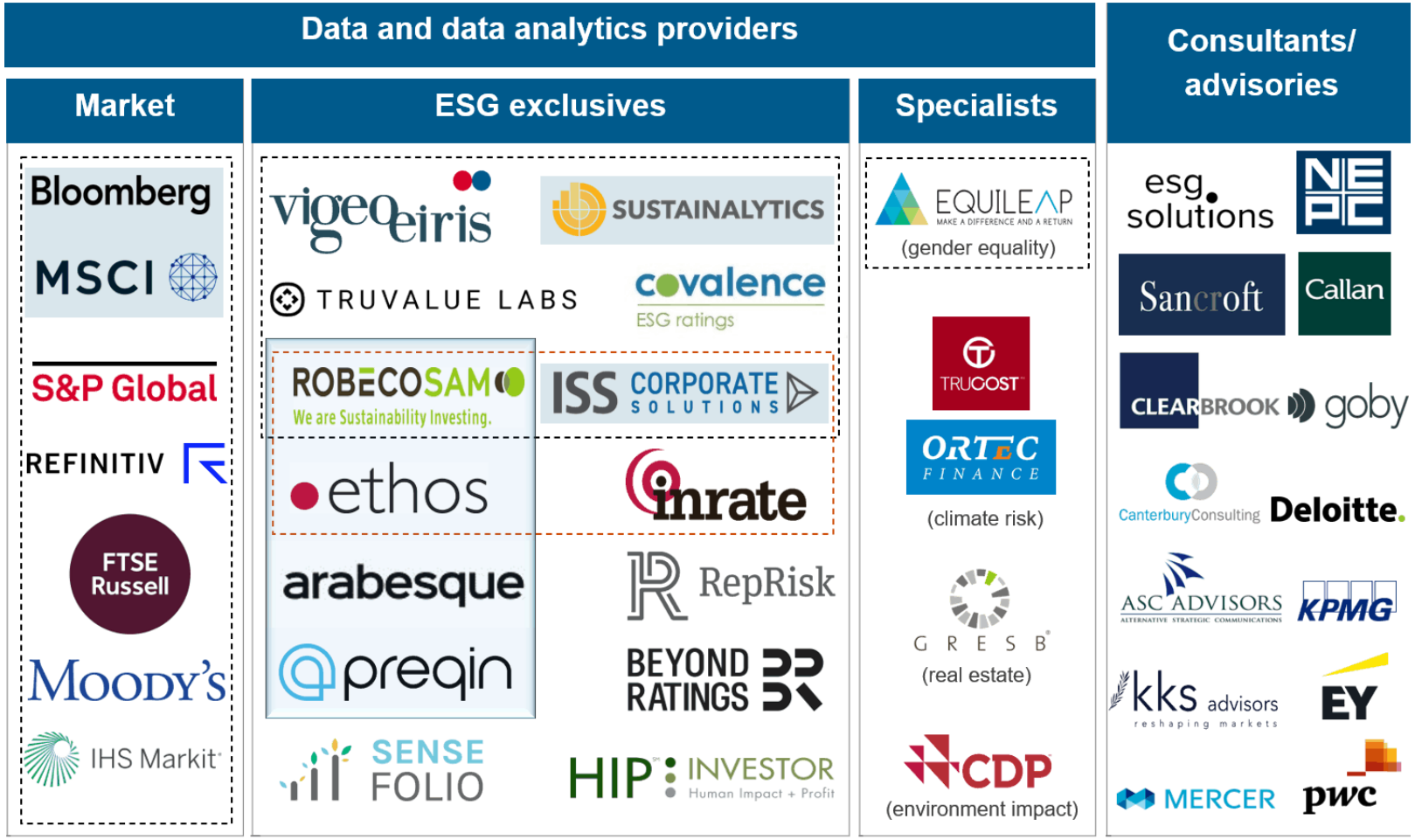


1.5 degree aligned companies per MSCI increased from 10% in 2020 to 22% in 2023

© 2022 ACA Group. All rights reserved.

Sources: MSCI ESG Research, data as of May 31, 2023. Ethos research, data as of October 1, 2023

4 Explosion of available providers and data

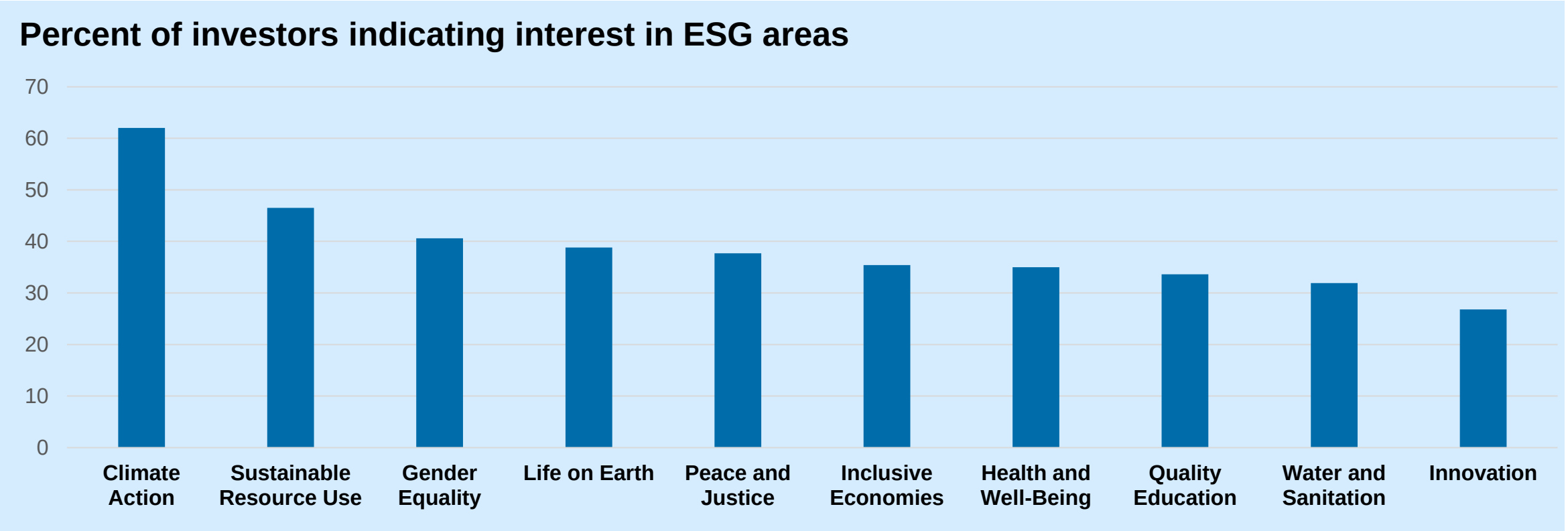


- Many options, depending on your products and reporting needs
- Opportunities for improved specialized data and cost savings
- Consulting and data together can be helpful in some cases

© 2022 ACA Group. All rights reserved.

Source: Everest Group

5 6 Climate continues to be most important for investors



- Climate action remains most important; increasingly important sub-issues include transition finance and net-zero
- Biodiversity (Life on Earth) growing in importance
- Equality and justice issues also rising in importance (LGBTQ equality, racial justice, inclusive economies issues)

© 2022 ACA Group. All rights reserved.

Based on more than 5,000 questionnaires completed by investors on Ethos

7 Increasing availability across asset classes

Private markets

- Providers offering private markets data or data collection tools has exploded
- Increasing requirements for private markets to report under same guidelines as public companies (e.g., California climate law)
- Data still generally limited to private investors (not made public)

Fixed income

- Converging views on methodology to measure carbon footprint for fixed income investment (e.g., Partnership for Carbon Accounting Financials)
- Some acceptance of considering the issuer or parent company where necessary
- Increased analysis of the issuance, especially for green bonds and social bonds

Real Estate, Alts and others

- Increasing standardization and guidance for measuring real estate ESG data, especially on climate, carbon and energy
- Limited guidance or standardization on measuring carbon or other ESG data for many Alts
- Increasing amount of work being done using supply chains and location-based analysis – e.g., commodities based on mining locations

ACA™ © 2022 ACA Group. All rights reserved.

8 Evolving ESG data regulation – US

California Climate Legislation

- Will require certain US companies doing business in CA to provide climate disclosures
- Requires GHG emissions and climate risk-related information
- 5-10K companies may be required to disclose; 80 percent are privately held
- Builds on GHG Protocol and the TCFD

Proposed SEC Climate Rule

- Will require US public companies to disclose GHG emissions and climate-related risks
- Scope 1 and 2 required, Scope 3 if material
- Builds on GHG Protocol and the TCFD

State-level regulation

- Several anti-ESG state-level bills
- 22 states have adopted some form of ESG-related laws
- 18 states have adopted “anti-ESG” legislation (14 in 2023). Generally limit the consideration of ESG factors to financial decision making

Others upcoming

- SEC Draft Rule 87 FR 36654: seeks to categorize certain types of ESG strategies and require funds and advisers to provide more specific disclosures based on the ESG strategies they pursue

SEC’s 2024 examination priorities does not mention ESG (released October 16, 2023)

ACA™ © 2022 ACA Group. All rights reserved.

8 SEC enforcement action example: DWS

Deutsche Bank Subsidiary DWS to Pay $25 Million for Anti-Money Laundering Violations and Misstatements Regarding ESG Investments

- Focused on misstatements regarding ESG investment process
- Found that DWS made “materially misleading statements” about its controls for incorporating ESG factors into research and investment recommendations
- DWS failed to adequately implement certain provisions of its global ESG integration policy as it had led clients and investors to believe it would
- “Investment advisers must ensure that their actions conform to their words”

ACA™ © 2022 ACA Group. All rights reserved.

8 Evolving ESG data regulation – Europe

EU Taxonomy

- Provides the classification framework for sustainable activities
- Sets criteria to determine if an economic activity can be considered sustainable
  - Assigned to a defined taxonomy activity
  - Contribute to one of six environmental objectives
  - Do no significant harm
  - Comply with a series of minimum social safeguards

SFDR and SDR

- Sustainable Finance Disclosure Regulation (SFDR)
  - EU
  - Articles 6, 8 and 9
  - Product-level and entity-level
- UK Sustainable Disclosure Regulation (SDR)
  - UK
  - Focus, Impact, Improve

Corporate Sustainability Reporting Directive (CSRD)

- Starting in 2024, will require more than 50,000 companies globally to disclose numerous ESG factors
- Will start with largest companies and add others, including non-EU companies with subsidiaries in the EU
- Includes “double materiality”

Others upcoming

- European Union Deforestation Regulation
- Corporate Sustainability Due Diligence Directive

ACA™ © 2022 ACA Group. All rights reserved.

9 Potential for AI to improve ESG data

Potential benefits

- **Accuracy**: use machine learning to improve the accuracy of ESG metrics
- **Prediction**: AI can increase the accuracy and comprehensiveness of models used to fill gaps in ESG data disclosure
- **Satellite tech**: AI-powered satellite imaging can increasingly detect negative environmental patterns and risks

Risks

- **Data privacy**: AI generally relies on large datasets collected from public information, but also often incorporates private information or datasets
- **Reliability**: reliability of AI-collected data such as satellite imagery or natural language processing has improved significantly, but still not perfect
- **Model bias**: AI models generally rely on human-set assumptions and priorities, meaning they often prioritize what the creator believes to be most important

ACA™ © 2022 ACA Group. All rights reserved.

Questions

Luke Wilcox

Partner, Head of Ethos ESG

luke.wilcox@acaglobal.com

© 2022 ACA Group. All rights reserved.