ESG and data: The need for consistency

We examine the urgent need for greater consistency and definitive guidelines when assessing sustainable investments

As responsible investors, we need to have confidence in the public statements and reports published by the companies we invest in. If anything, as sustainable investing grows, the reliance on data is becoming increasingly evident, as is the need for that data to be consistent and of high quality.

As an industry, we must be conscious of the methodologies data providers use and ensure that we are aligned with them, should we use them. We anticipate that data providers should soon expect to receive increased regulatory attention as more and more capital is directed into specific sustainable and ESG-related strategies off the back of third-party ESG ratings providers.

At Newton, while we are cognisant of third-party ratings, we think it prudent to focus more on the raw data provided by companies, where this is available and accessible. This data is often either audited or assured and reported directly by the companies themselves.

That is not to say that we don't believe that third-party ESG data can be a useful tool; it is important to understand where third-party data providers' and rating agencies' current thinking is, as part of a holistic approach to assessing the sustainability and ESG credentials of companies. We believe it is also important to understand and be comfortable with the methodology one is choosing to rate investments from a sustainability or ESG perspective.

Take the tackling of climate change, for example. While this is still a nascent area, examining the temperature alignment of a portfolio to see if it is consistent with the goal of minimising global warming is among the most developed in terms of ESG analysis. Again, the need for consistency comes to the fore. At Newton, we have taken a random portfolio from our investment universe and undertaken a temperature alignment analysis using three different methodologies: one came out showing it to be aligned with a 1.5-degree Celsius rise, the second methodology indicated a 2.5-degree Celsius rise, and the third revealed a rise of 4 degrees Celsius.

Given this significant disparity, the natural tendency would be to pick the one with the lowest temperature increase, but because this is a nascent space where methodologies are changing frequently, it is not a question of simply selecting the one that gives the best results. Instead, providing a consistent methodology so investors can make an effective comparison between different strategies and companies' ESG credentials is paramount.

Once the correct approach has been determined, it needs to be maintained and widely adopted, but we are yet to reach the point at which the best approach has been determined and adopted across all industries, including the investment industry.

There are frameworks being developed to this end, notably from CDP (formerly the Carbon Disclosure Project), which has been reporting for over a decade, and which is providing some consistency because it requires companies to report against its framework. However, the CDP framework is not being reported in a uniform way across different jurisdictions – a requirement for most global investors.

At the United Nations Climate Change Conference (COP26) last November, the International Sustainability Standards Board (ISSB) was created to work alongside the longstanding International Financial Reporting Standards (IFRS) on accounting standards. The ISSB will be convening soon to establish a board which should start producing a framework and methodologies over the next 18 months, so that companies can be provided with a useful structure and guide rails to determine the qualitative factors needed for consistent ESG data reporting.

Accounting frameworks and standards have been in place for over a century, and while there are no agreed accounting standards for ESG considerations as yet, we believe a shift in momentum is finally under way. As a member of the IFRS Advisory Council, I see first-hand how various parts of the accounting standards framework are under constant and thorough scrutiny and review to find the path of best fit across the multitude of stakeholders. We believe the ISSB will ultimately follow a similar model, using stakeholder inclusion to arrive at the best possible framework to ensure a level of consistency for the global ESG rating of individual companies.

Written by Ian Burger, Head of responsible investment, Newton Investment Management

In association with NEWTON Investment Management