



Future FirstSM Insights

ESG Data and Regulatory Challenges in a Fast-Changing World

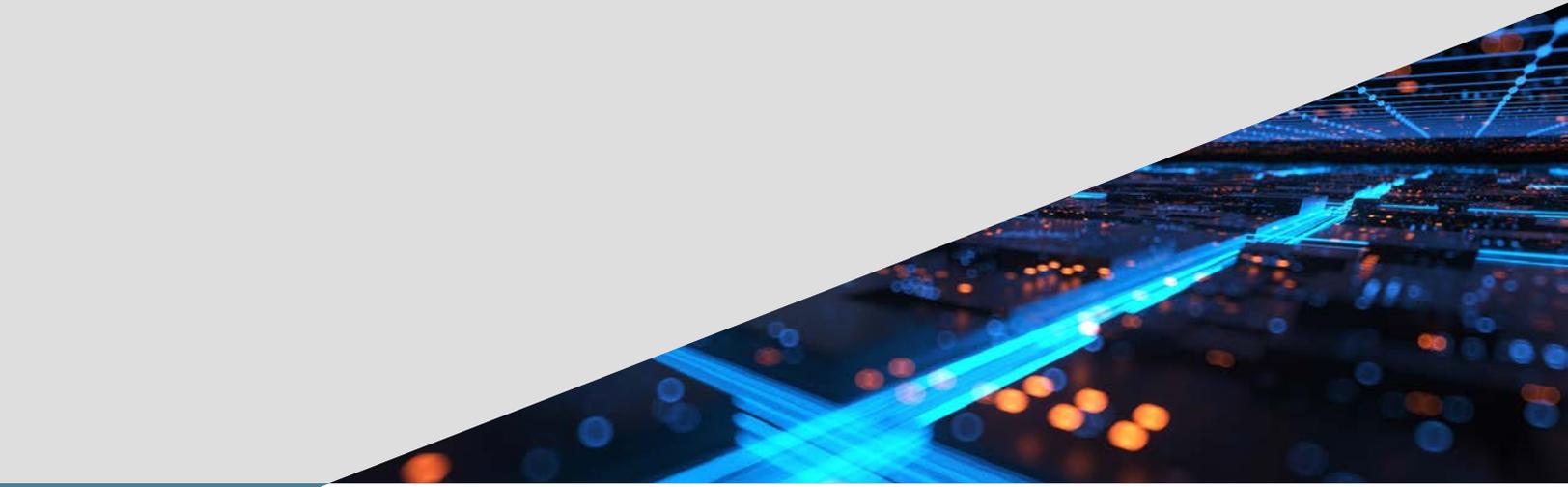
By Fiona McNally, Corinne Neale and Aaron Todd

Less than a decade ago, investment focused on environmental, social and governance (ESG) factors was a relatively small niche within the asset management world. Increasing awareness of the risks of climate change in the years since the Paris Agreement of 2015, extreme weather events that challenge human survival and threaten economic growth, and the coming of age of a new generation of investors that prioritize ESG considerations, are driving an increase in the scale of ESG investment and its importance within the industry.

Global ESG assets are likely to exceed \$53 trillion by 2025, representing more than a third of the \$140.5 trillion in projected total assets under management.ⁱ Put simply, investment management firms that ignore ESG considerations may risk losing clients and face investment underperformance as the world shifts to a more sustainable footing.

Institutional investors including asset managers, asset owners and pension fund providers require tools and transparency to make ESG investing a reality. To this end, many have already begun mapping their “impact processes” and integrating screening tools into their investment protocols, incorporating ESG priorities, obligations and expectations, along with a roadmap of regulatory compliance responsibilities. This process is a vast undertaking that is currently complicated by **inconsistent data quality** and **differing national and regional approaches to ESG regulation**, which creates particular challenges for global investors.

ⁱ <https://www.bloomberg.com/professional/blog/esg-assets-may-hit-53-trillion-by-2025-a-third-of-global-aum/yeah>



The Data Conundrum

The key challenges for asset managers when managing a fund that seeks to achieve a specific ESG objective are data availability, consistency and fitness for purpose. The absence of consistent, robust, verified and widely accepted data standards makes it difficult to compare the ESG characteristics of a company that is a potential investment target against another. Data may be entirely missing for certain metrics and asset classes, excluding them effectively from investment analysis.

Equally, shortcomings in data have implications for the downstream obligations that arise from regulatory requirements. To comply with regulatory reporting requirements, risk managers need to be able to show that their investment choices are aligned with regulatory goals from an ESG perspective. It is essential to have a link between stated corporate goals, decision-making at portfolio level and reporting further downstream. Without it, an asset manager could face accusations of greenwashing and reputational damage.

In time, inconsistent reporting by underlying investee companies for foundational metrics will be addressed by initiatives such as the proposal by the European Union (EU) for a Corporate Sustainability Reporting Directive (CSRD), which will ensure in-scope entities provide consistent and comparable sustainability information. However, the CSRD is expected to apply to in-scope companies only from 2024; asset managers active in the EU will be required to report defined metrics at a product level under the Sustainable Finance Disclosure Regulation (SFDR) from July 2022. In the interim period, there may be considerable uncertainty about the availability and reliability of data.

ESG data can typically be sourced in one of three ways:

- First, companies may make ESG data publicly available in publications and the asset manager can collect it via its in-house research team. One problem with relying on such information is that there is no common standard for companies when reporting. Companies may also be tempted to use language and metrics that they think will appeal to investors instead of metrics and language reflecting their own corporate goals. Without predetermined standards, reaching a decision about which of two companies is the more climate-friendly, for example, is difficult.
- Second, the asset manager may obtain ESG data as part of its regular company visits to facilitate due diligence and analysis of potential investment targets. The more detailed engagement afforded by such an approach means that the asset manager has greater control over the information it sources and it is therefore likely to be more valuable when comparing one company against another. The downside of this approach is that it is resource intensive; even the largest asset management firms may find it difficult to source such information on their entire potential investment universe.
- Third, the asset manager can use third-party data providers to collate and provide ESG-related data relating to underlying investee companies. There is a wide range of such providers, including open-source providers, industry groups and data vendors. While third-party data providers are becoming more sophisticated overall, their coverage varies widely. The time periods and metrics collected relating to investee companies can also vary – data consistency is by no means guaranteed. Evaluating the approach of each provider is time-consuming. Given current limited coverage, it is very common for asset managers to use multiple data sources, requiring normalization across sources to blend data. As data is expensive, asset managers appreciate usage and coverage metrics in what is a very rapidly expanding market.



Industry Awaits Harmonization of Regulation Regimes

In 2015, under the Paris Agreement, 195 countries set a target to keep average global temperature change below 2°C and as close as possible to 1.5°C. At COP26 in Glasgow in November 2021, countries have now agreed to revisit their commitments, as necessary, by the end of 2022 to put the world on track for 1.5°C of warming, maintaining the upper end of ambition under the Paris Agreement. In order to deliver on these promises, participants at COP26 also agreed for the first time to accelerate efforts toward the phase-down of unabated coal power and inefficient fossil fuel subsidies, and recognized the need for support toward a just transition. All the while, the pace of regulatory initiatives focused on climate change and other ESG issues (designed to meet countries' Paris obligations) has quickened.

While the goal of various regimes is broadly similar – principally to limit carbon emissions to agreed limits by requiring companies and investors to publish exposures and other risk factors – approaches taken differ widely (see below section, “ESG Regulatory Approaches Around the World”).

Most notably, some jurisdictions have voluntary regimes, such as those based on the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). Others are mandatory, such as the EU’s SFDR, which is widely perceived to be the most advanced and ambitious.

Similarly, the emphasis of various regimes differs. The focus in Europe and the UK has been primarily on environmental factors (especially climate-related considerations) and in particular the disclosures needed to provide transparency to investors so that they can compare similar investments. In contrast, to date the U.S. has focused to a greater extent on the social aspects of ESG, although this could soon change given the prioritization of climate change by President Biden (symbolized by the U.S.'s return to the Paris agreement).

The fragmentation of ESG reporting frameworks, differences between regional regulatory approaches, the lack of standardized taxonomies that establish environmentally sustainable economic activities, and varying and complex data requirements are problematic, especially for firms that have operations in multiple jurisdictions. They may be subject to jurisdiction-specific ESG regulatory requirements and will face hurdles and ESG transparency requirements when distributing funds into other regions.

Over time, some of these disparities may be reduced. As the U.S. and other countries develop solutions to encourage investment in more sustainable economic activities, they are likely to draw inspiration from sustainability-related financial market regulations in other parts of the world.

ESG Regulatory Approaches Around the World

Europe

- The Sustainable Finance Disclosure Regulation (SFDR) contains transparency rules both at entity level and relating to financial products for financial market participants such as asset managers.
- The EU Taxonomy Regulation establishes an EU-wide classification system or “framework” intended to provide businesses and investors with a common language to identify the extent to which economic activities can be considered environmentally sustainable.
- A proposal for a Corporate Sustainability Reporting Directive (CSRD) will amend the existing Non-Financial Reporting Directive (NFRD) and ensure in-scope entities provide consistent and comparable sustainability information.
- The Markets in Financial Instruments Directive (MiFID II), Undertakings for Collective Investment in Transferable Securities (UCITS), the Alternative Investment Fund Managers Directive (AIFMD), the Insurance Distribution Directive (IDD) and Solvency II will be amended. The objective will be to ensure that in-scope entities, such as investment firms and insurers, include sustainability risks in their procedures and sustainability preferences in investment decisions for, or advice, to clients.

United Kingdom

- There will be mandatory economy-wide disclosures

(including for the financial sector) in line with the Task Force on Climate-related Financial Disclosures (TCFD).

- The UK government has announced that it will implement a Green Taxonomy based on the EU Green Taxonomy.
- New Sustainability Disclosure Requirements (SDRs) look set to draw heavily not only from the TCFD but also from the EU’s sustainability approach. SDRs will apply to financial services firms, companies and pension funds and will require them to report the impact of their organization and financial products on climate change and the environment, and the impact of climate change on their organizations. SDRs will be more comprehensive than the TCFD framework and require more comprehensive disclosures; they will be phased in over the coming years.

United States

- ESG reporting and disclosure remains voluntary for companies. However, a shift to mandatory reporting is expected.
- FSOC recently released their Report and Recommendations on Climate-related Financial Risk in response to President Biden’s Executive Order 14030, Climate-related Financial Risk demonstrating their commitment to building on and accelerating existing efforts on climate change through concrete recommendations for member agencies.

- The Securities and Exchange Commission (SEC) has solicited public comments on 15 questions regarding climate and ESG disclosure to determine how it should best promote consistent, comparable, and reliable climate change disclosure and consider third-party frameworks and standards.
- The SEC also plans to update its 2010 guidance on existing disclosure requirements for climate change matters.
- The SEC’s Asset Management Advisory Committee recently formed an ESG Subcommittee to explore the necessity to integrate ESG more explicitly into its regulatory framework.
- The Commodity Futures Trading Commission (CFTC) is expected to finalize rules that would codify and standardize climate disclosures for publicly traded companies.

APAC

- Several APAC countries have developed local standards and taxonomies, such as the Green Bond Taxonomy of 2015 in China and the Climate Change and Principle-based Taxonomy of 2020 in Malaysia.
- Country-specific reporting and disclosure frameworks for listed companies have been introduced in several countries, including China, Australia, Malaysia and India.

An aerial photograph of a large solar farm, showing rows of solar panels stretching across a landscape. The panels are arranged in a grid pattern, and the colors range from dark blue to light blue, with some panels appearing to have a reddish or orange tint, possibly due to the lighting or the type of panels. The perspective is from a high angle, looking down at the panels, which recede into the distance.

The Right Tools for the Job

Institutional investors need tools to help in their investment selection process, so that they can understand the ESG implications of their investment decisions and show investors and prospective investors the veracity and rigor of their approach to ESG. Any solution should be able to help users explore and identify the ESG components aligned to their values and goals, how these components are scored and how they can inform and support specific investment strategies and objectives. In a recent BNY Mellon analysis conducted for a client with an international equity portfolio, we identified a need for three separate vendor data sources to provide actual carbon data coverage (as opposed to estimated) for the entire portfolio.

At the same time, institutional investors need a regulatory reporting solution that enables risk managers to meet disclosure and transparency requirements and demonstrates how a fund or mandate performs against its objectives. Any potential solution should streamline compliance (by automatically populating SFDR templates, for example) and take account of evolving regulatory regimes by adjusting formatting and the information provided to accommodate new requirements such as the UK's forthcoming Sustainability Disclosure Requirements and any forthcoming rules introduced by the SEC and regulators in APAC, for instance. Tools to help with ESG investment and regulatory reporting need to be linked and automated to support the management of regulatory exposures and demonstrate that adverse impact factors are progressively managed down, as well as to minimize the back-office burden for institutional investors.

There are many approaches to ESG integration and mitigation and all of them need to be accommodated. For example, some portfolio managers use ESG exclusions that omit fossil fuel producers such as oil companies because of their carbon emissions. Other approaches focused on identifying impact opportunities, for example, might allow investment in such companies because they are committed to changing their business model and expanding their renewable energy production or hold valuable patents for renewable technologies and could therefore be important in combating climate change. Any solution should therefore be customizable to the needs and objectives of institutional investors, so it can reflect their ESG preferences at an individual fund level.



Planning for the Future

The importance of ESG in the asset management world will only grow in the coming years. Climate change and social and governance issues have captured the imagination of many end investors, so it is imperative that asset managers evolve their mindset and processes in order to prosper in the coming years. ESG issues also now dominate political discourse. Momentum for more stringent ESG measures – both for society as a whole and financial markets in particular – will only grow, while regulatory standards continue to evolve in Europe while mandatory disclosure looks likely in the U.S.

To address these challenges cost effectively and reshape their organization for the ESG challenges and opportunities to come, institutional investors need to proactively consider the solutions available, so they can better understand the impact of ESG factors on their portfolios and ensure they have effective regulatory reporting processes in place.

[Learn more about BNY Mellon's ESG data analytics and regulatory compliance solutions.](#)

Fiona McNally, Director, Regulatory Business Solutions, *BNY Mellon*

Aaron Todd, Head of Regulatory Business Solutions, *BNY Mellon*

Corinne Neale, Global Head of Business Applications for Data & Analytics Solutions, *BNY Mellon*

At BNY Mellon, we're committed to putting the *Future First*SM by using our global reach, influence and resources not just to power success today, but to help safeguard the future. We aim to accelerate the evolution of ESG – on behalf of clients, investors, communities and all stakeholders – to make a positive impact on people and the planet. For more information, visit www.bnymellon.com/futurefirst.

BNY Mellon is the corporate brand of The Bank of New York Mellon Corporation and may be used to reference the corporation as a whole and/or its various subsidiaries generally. This material and any products and services may be issued or provided under various brand names of BNY Mellon in various countries by duly authorized and regulated subsidiaries, affiliates, and joint ventures of BNY Mellon, which may include any of those listed below:

The Bank of New York Mellon, a banking corporation organized pursuant to the laws of the State of New York, whose registered office is at 240 Greenwich St, NY, NY 10286, USA. The Bank of New York Mellon is supervised and regulated by the New York State Department of Financial Services and the US Federal Reserve and is authorized by the Prudential Regulation Authority (PRA) (Firm Reference Number: 122467). In the U.K., a number of services associated with BNY Mellon Wealth Management's Family Office Services – International are provided through The Bank of New York Mellon, London Branch. The Bank of New York Mellon also operates in the UK through its London branch (UK companies house numbers FC005522 and BR000818) at One Canada Square, London E14 5AL and is subject to regulation by the Financial Conduct Authority (FCA) at 12 Endeavour Square, London, E20 1JN, UK and limited regulation by the PRA at Bank of England, Threadneedle St, London, EC2R 8AH, UK. Details about the extent of our regulation by the PRA are available from us on request.

Investment management services are offered through BNY Mellon Investment Management EMEA Limited, BNY Mellon Centre, One Canada Square, London E14 5AL, which is registered in England No. 1118580 and is authorised and regulated by the Financial Conduct Authority. Offshore trust and administration services are through BNY Mellon Trust Company (Cayman) Ltd.

BNY Mellon Fund Services (Ireland) Limited is regulated by the Central Bank of Ireland.

The Bank of New York Mellon SA/NV, a Belgian public limited liability company, with company number 0806.743.159, whose registered office is at 46 Rue Montoyerstraat, B-1000 Brussels, Belgium, authorised and regulated as a significant credit institution by the European Central Bank (ECB), under the prudential supervision of the National Bank of Belgium (NBB) and under the supervision of the Belgian Financial Services and Markets Authority (FSMA) for conduct of business rules, a subsidiary of The Bank of New York Mellon.

The Bank of New York Mellon SA/NV operates in Ireland through its Dublin branch at Riverside II, Sir John Rogerson's Quay Grand Canal Dock, Dublin 2, D02KV60, Ireland and is registered with the Companies Registration Office in Ireland No. 907126 & with VAT No. IE 9578054E. The Bank of New York Mellon SA/NV, Dublin Branch is subject to limited additional regulation by the Central Bank of Ireland at New Wapping Street, North Wall Quay, Dublin 1, D01 F7X3, Ireland for conduct of business rules and registered with the Companies Registration Office in Ireland No. 907126 & with VAT No. IE 9578054E.

The Bank of New York Mellon SA/NV is trading in Germany as The Bank of New York Mellon SA/NV, Asset Servicing, Niederlassung Frankfurt am Main, and has its registered office at MesseTurm, Friedrich-Ebert-Anlage 49, 60327 Frankfurt am Main, Germany. It is subject to limited additional regulation by the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, Marie-Curie-Str. 24-28, 60439 Frankfurt, Germany) under registration number 122721.

The Bank of New York Mellon SA/NV operates in the Netherlands through its Amsterdam branch at Strawinskylaan 337, WTC Building, Amsterdam, 1077 XX, the Netherlands. The Bank of New York Mellon SA/NV, Amsterdam Branch is subject to limited additional supervision by the Dutch Central Bank ("De Nederlandsche Bank" or "DNB") on integrity issues only (registration number 34363596). DNB holds office at Westeinde 1, 1017 ZN Amsterdam, the Netherlands.

The Bank of New York Mellon SA/NV operates in Luxembourg through its Luxembourg branch at 2-4 rue Eugene Ruppert, Vertigo Building – Polaris, L- 2453, Luxembourg. The Bank of New York Mellon SA/NV, Luxembourg Branch is subject to limited additional regulation by the Commission de Surveillance du Secteur Financier at 283, route d'Arion, L-1150 Luxembourg for conduct of business rules, and in its role as UCITS/AIF depositary and central administration agent.

The Bank of New York Mellon SA/NV operates in France through its Paris branch at 7 Rue Scribe, Paris, France, 75009, France. The Bank of New York Mellon SA/NV, Paris Branch is subject to limited additional regulation by Secrétariat Général de l'Autorité de Contrôle Prudentiel et Prémière Direction du Contrôle de Banques (DCB 1), Service 2, 61, Rue Taïbout, 75436 Paris Cedex 09, France (registration number (SIREN) Nr. 538 228 420 RCS Paris - CIB 13733).

The Bank of New York Mellon SA/NV operates in Italy through its Milan branch at Via Mike Bongiorno no. 13, Diamantino building, 5th floor, Milan, 20124, Italy. The Bank of New York Mellon SA/NV, Milan Branch is subject to limited additional regulation by Banca d'Italia – Sede di Milano at Divisione Supervisione Banche, Via Cordusio no. 5, 20123 Milano, Italy (registration number 03351).

The Bank of New York Mellon SA/NV is trading in Denmark as The Bank of New York Mellon SA/NV, Copenhagen Branch, filial af The Bank of New York Mellon SA/NV, Belgium, and has its registered office at Strandvejen 60/5, 2900 Hellerup, Denmark. It is subject to limited additional regulation by the Danish Financial Supervisory Authority (Finanstilsynet, Århusgade 110, 2100 København Ø).

The Bank of New York Mellon SA/NV operates in Spain through its Madrid branch with registered office at Calle José Abascal 45, Planta 4ª, 28003, Madrid, and enrolled on the Reg. Mercantil de Madrid, Tomo 41019, folio 185 (M-727448). The Bank of New York Mellon, Sucursal en España is registered with Banco de España (registration number 1573).

The Bank of New York Mellon SA/NV operates in England through its London branch at 160 Queen Victoria Street, London EC4V 4LA, UK, registered in England and Wales with numbers FC029379 and BR014361. The Bank of New York Mellon SA/NV, London branch is authorized by the ECB (address above) and is deemed authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details of the Temporary Permissions Regime, which allows EEA-based firms to operate in the UK for a limited period while seeking full authorisation, are available on the Financial Conduct Authority's website.

The Bank of New York Mellon (International) Limited is registered in England & Wales with Company No. 03236121 with its Registered Office at One Canada Square, London E14 5AL. The Bank of New York Mellon (International) Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

Regulatory information in relation to the above BNY Mellon entities operating out of Europe can be accessed at the following website: <https://www.bnymellon.com/RID>.

The Bank of New York Mellon, Singapore Branch, is subject to regulation by the Monetary Authority of Singapore. For recipients of this information located in Singapore: This material has not been reviewed by the Monetary Authority of Singapore. The Bank of New York Mellon, Hong Kong Branch (a branch of a banking corporation organized and existing under the laws of the State of New York with limited liability), is subject to regulation by the Hong Kong Monetary Authority and the Securities & Futures Commission of Hong Kong.

The Bank of New York Mellon is exempt from the requirement to hold, and does not hold, an Australian financial services license as issued by the Australian Securities and Investments Commission under the Corporations Act 2001 (Cth) in respect of the financial services provided by it to persons in Australia. The Bank of New York Mellon is regulated by the New York State Department of Financial Services and the US Federal Reserve under Chapter 2 of the Consolidated Laws, The Banking Law enacted 16th April 1914 in the State of New York, which differs from Australian laws.

The Bank of New York Mellon has various other branches in the Asia-Pacific Region which are subject to regulation by the relevant local regulator in that jurisdiction.

The Bank of New York Mellon Securities Company Japan Ltd, as intermediary for The Bank of New York Mellon.

The Bank of New York Mellon, DIFC Branch, regulated by the Dubai Financial Services Authority (DFSA) and located at DIFC, The Exchange Building 5 North, Level 6, Room 601, P.O. Box 506723, Dubai, UAE, on behalf of The Bank of New York Mellon, which is a wholly-owned subsidiary of The Bank of New York Mellon Corporation.

Pershing is the umbrella name for Pershing LLC (member FINRA, SIPC and NYSE), Pershing Advisor Solutions (member FINRA and SIPC), Pershing Limited (UK), Pershing Securities Limited (UK), Pershing Securities International Limited (Ireland), Pershing (Channel Islands) Limited, Pershing Securities Canada Limited, Pershing Securities Singapore Private Limited, and Pershing India Operational Services Pvt Ltd. Pershing business also includes Albridge Solutions, Inc. and Lockwood Advisors, Inc., an investment adviser registered in the United States under the Investment Advisers Act of 1940. Pershing LLC is a member of SIPC, which protects securities customers of its members up to \$500,000 (including \$250,000 for claims for cash). Explanatory brochure available upon request or at sipc.org. **SIPC does not protect against loss due to market fluctuation. SIPC protection is not the same as, and should not be confused with, FDIC insurance.**

Past performance is not a guide to future performance of any instrument, transaction or financial structure and a loss of original capital may occur. Calls and communications with BNY Mellon may be recorded, for regulatory and other reasons.

Disclosures in relation to certain other BNY Mellon group entities can be accessed at the following website: <http://disclaimer.bnymellon.com/eu.htm>.

This material is intended for wholesale/professional clients (or the equivalent only), is not intended for use by retail clients and no other person should act upon it. Persons who do not have professional experience in matters relating to investments should not rely on this material. BNY Mellon will only provide the relevant investment services to investment professionals.

Not all products and services are offered in all countries.

If distributed in the UK, this material is a financial promotion. If distributed in the EU, this material is a marketing communication.

This material, which may be considered advertising, is for general information purposes only and is not intended to provide legal, tax, accounting, investment, financial or other professional advice on any matter. This material does not constitute a recommendation or advice by BNY Mellon of any kind. Use of our products and services is subject to various regulations and regulatory oversight. You should discuss this material with appropriate advisors in the context of your circumstances before acting in any manner on this material or agreeing to use any of the referenced products or services and make your own independent assessment (based on such advice) as to whether the referenced products or services are appropriate or suitable for you. This material may not be comprehensive or up to date and there is no undertaking as to the accuracy, timeliness, completeness or fitness for a particular purpose of information given. BNY Mellon will not be responsible for updating any information contained within this material and opinions and information contained herein are subject to change without notice. BNY Mellon assumes no direct or consequential liability for any errors in or reliance upon this material.

This material may not be distributed or used for the purpose of providing any referenced products or services or making any offers or solicitations in any jurisdiction or in any circumstances in which such products, services, offers or solicitations are unlawful or not authorized, or where there would be, by virtue of such distribution, new or additional registration requirements.

BNY Mellon Wealth Management conducts business through various operating subsidiaries of The Bank of New York Mellon Corporation.

Any references to dollars are to US dollars unless specified otherwise.

This material may not be reproduced or disseminated in any form without the prior written permission of BNY Mellon. Trademarks, logos and other intellectual property marks belong to their respective owners.

The Bank of New York Mellon, member of the Federal Deposit Insurance Corporation (FDIC).

bnymellon.com

Please click here for additional information regarding disclaimers and disclosures.

© 2021 The Bank of New York Mellon Corporation. All rights reserved.