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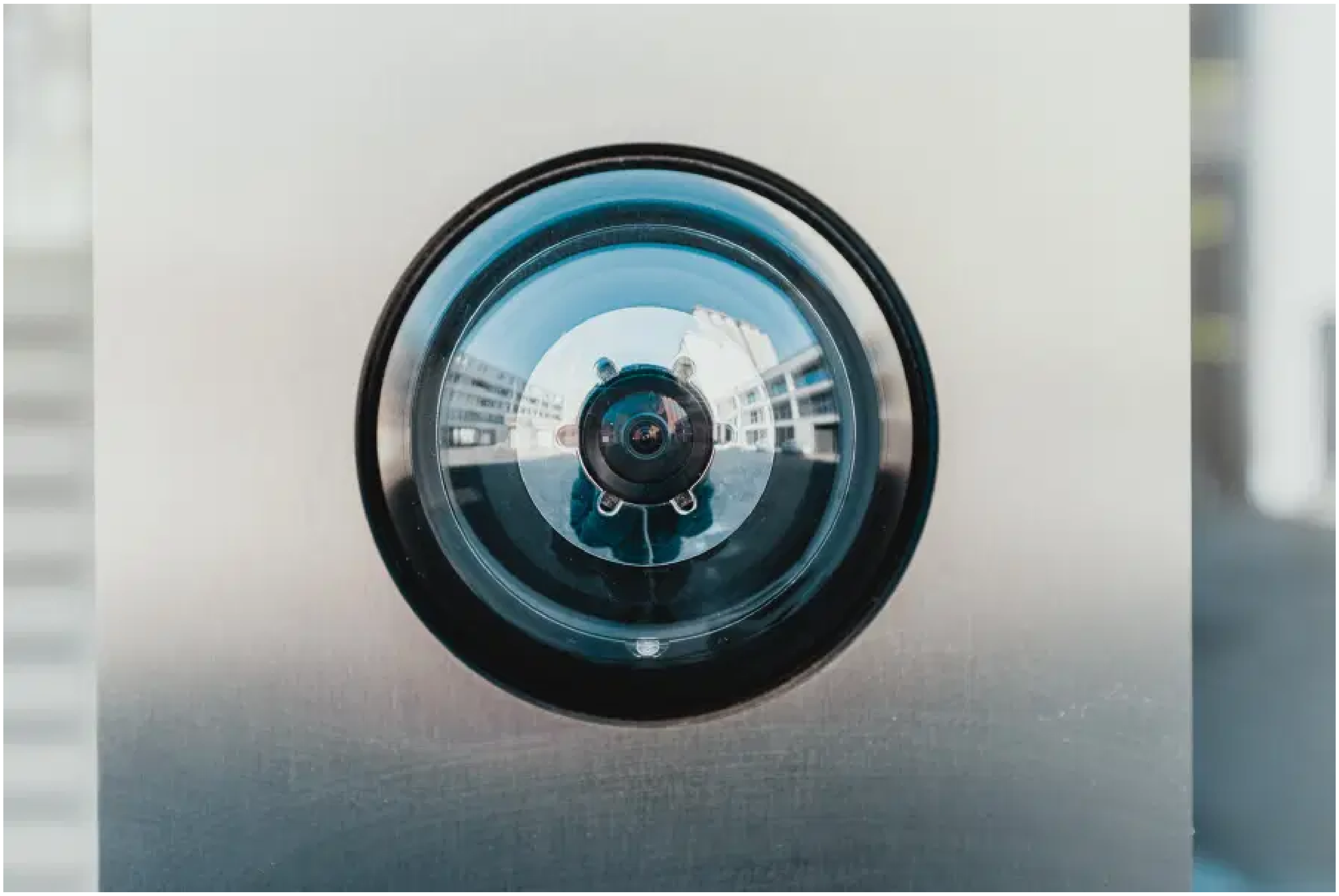

A CATALYTIC MOMENT FOR ESG DATA AND RATING

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Erica Lasdon is a seasoned ESG professional bringing 20+ years of experience from the investment and non-profit sectors. Erica played a central role in ESG investment functions at Calvert, a responsible investment pioneer. As Director of Sustainability Research, she directed development of the in-house ESG investment ratings system, used in 2015 to launch new investment products and revamp the existing product suite. Erica has deep expertise on ESG data analysis and management, ESG integration, multi-stakeholder engagement, proxy voting, and impact trends.

The Need for ESG Data in Imagining Big Capital

Environmental, Social, and Governance (ESG) data has changed enormously since the early days of Socially Responsible Investing, when printed materials were used to identify company involvement in activities or practices to be avoided. Since then, environmental and governance concerns have transformed the needs for and importance of data that are required today.

A handful of major global players emerged by 2010, growing primarily through acquisition. The products that developed included a growing set of ESG data and ratings based on the providers analysis of that data, all based mostly on ESG metrics that companies disclosed voluntarily.

In recent years, the consolidation has continued and larger financial industry firms like Moody's, S&P, and Morningstar are now the ultimate parents of many ESG data and ratings providers. Major ratings agencies and index providers are now deeply involved in ESG data.

Looking back on 2020, we see these key trends from the past decade:

Large-Cap Corporate Disclosure Boomed

One of the most reported facts is the rate of overall sustainability reporting within the S&P 500, the key large-cap US benchmark. According to the G&A Institute, 90% of index constituents issued a sustainability report in 2020, a massive increase from 20% in 2011. The overall ESG data set has expanded significantly.

Voluntary Frameworks Dominated

In 2010, a few voluntary frameworks guided companies reporting ESG data, which was then gathered by investors and specialized data services.

In 2020, there's an abundance of detailed guidance and tools for corporate reporters and other market participants. Detailed regulation on the horizon, as the robust and detailed EU taxonomy will begin to dictate leading approaches on climate change. The shift from voluntary to regulatory pressure is well underway.

ESG Investing Flourished

Morningstar tracked a 4x increase in ESG assets from 2018 to 2019 alone, from $5.5 bn to $20.6 bn. Participation in the UN Principles for Responsible Investment has soared as well, from 700+ signatories with $21 trillion AUM in 2010 to 3000+ signatories with over $100 trillion AUM in 2020. ESG investing has entered the mainstream in asset management.

Will the trends in these areas continue steadily in the next year? How will they shape the state of ESG data in the upcoming year? We expect to see significant increases in the volume, detail, and complexity of ESG information in 2021, with the following developments:

Corporate Disclosure Has Plenty of Room to Run, Expect Leaps in Quality and Volume

Sustainability reporting will be more common throughout broader equity benchmarks. Within the S&P 500, issuing a sustainability report is already basically standard practice. The quality and assurance of these reports will continue to steadily improve, driven by increased use of common frameworks like SASB, TCFD, and others.

Look to mid- and small cap companies, private from companies, and other issuers for signals of true growth in corporate disclosure. Formalized ESG reporting will quickly expand in companies outside the large-cap equity benchmarks.

Regulatory Schemes Mandating More Detailed Corporate ESG Disclosure will Steadily Expand

ESG standard setting done outside of formal government agencies is aligning and becoming more detailed. These soft and hard forms of regulation tended to be optional guidance and phrased broadly but are increasingly formal and required. NASDAQ's recent request to the SEC to implement diversity disclosure requirements for all listed companies is just one of many examples of this trend coming to fruition. Regulatory alignment will quickly drive large increases in ESG data.

ESG Investing has Moved from Niche Equity Products to an Approach Embedded in all Segments of the Capital Markets

As Russell Investments noted in a recent report, "fixed income market investors are taking notice and practitioners are quickly catching up," including non-corporate fixed income sectors like high-yield, bank loans, emerging markets debt, sovereign bonds, and municipal bonds. This means that ESG factors are being actively analyzed by the market, providing important feedback on material ESG data to corporations seeking capital. Broader ESG investor interest will amplify trends in ESG data volume and help drive quality improvements ahead of regulatory trends.

Does this mean that ESG data will quickly become as standardized as that derived from traditional corporate accounting? Of course not.

Similarly, the ESG ratings that are commercially available will continue to have meaningful differences, causing consternation from many. For those who can look beyond this, there are opportunities in this significant expansion in the detail, volume, and overall quality of ESG data.

Companies once had only vague guidance, but now have more information and tools to guide their technical and strategic work on ESG management for businesses. Investors who can step beyond the ratings to assess the wider set of ESG information can deepen their investment analysis through smart ESG integration and compete for assets better in an increasingly competitive marketplace. Finally, the regulators and others who seek to understand important ESG trends will have a far richer set of data to inform actions and research.

Market-led efforts and regulatory mechanisms will drive standardization in ESG data slowly

However, when it comes to ESG ratings, the most interesting immediate trend will not be alignment, but democratization. ESG ratings that used to be only available through expensive subscriptions are now more available to those who wish to find them for free. Investment firms are also building out ESG capacity and will be more able to develop ratings internally.

It won't be long before ESG data firms need to adjust their business models.

We expect climate, impact metrics and diversity issues to develop especially quickly in 2021

Corporate risk disclosure may also be quickly transformed by COVID response. However, at this time next year we would not be surprised to find transformation in currently nascent datasets in biodiversity, water, diversity, and human rights. The convergence of these trends may make one year seem like a decade.