

# The Golden Standard: How quantitative metrics can change ESG reporting

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# Introduction

ESG (environmental, social and governance) refers to three groupings of factors that can be used to measure the sustainability and ethical impact of an investment in a company or business.

These factors are used by financial services investment firms to help assess the future financial performance of companies. However, the process of defining, achieving and applying ESG metrics leads to differing research opinions that can create as much confusion as clarity. What, then, might be the best way to ensure client decisions are based on authentic measures of sustainability and impact?

Data is often described as the magic bullet that helps decision makers achieve income and growth based on well-informed and rational evidence. Certainly, the speedy and objectively empirical benchmarks from which data can be generated and analysed is hugely valuable for industries across all sectors that rely on accurate reporting of financial performance.

In both the investment pre-trade and post-trade environments, valid and timely data is similarly crucial for asset managers and owners who need the right periodic reporting to support their strategies. The variability of ESG measurements though poses challenges when those

metrics, that are largely designed for pre-trade investment purposes, are also needed to support periodic post-trade reporting on asset and fund ESG performance. To date, ESG scores and ratings data are more akin to qualitative research opinions than quantitative facts.

The discourse on ESG has moved on from niche to norm across markets and securities over the past decade, where there is little, if any, debate today about its fundamentally positive role in them. The challenge today, however, is one of providing transparent, credible and valid non-financial data in the periodic reporting that clients expect.

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# 1 > A case study in ESG Reporting

A key element of Securities Services is to support clients in meeting their regulatory, statutory and financial reporting obligations. Clients come to us as the trusted source to obtain their data to fulfill these obligations.

The challenge Securities Services has faced with ESG reporting is that although there is a plethora of ESG data available, including highly respected but differing research methodologies, there are very few commonly accepted, standardised and quantitative ESG data points that are suitable for use in periodic investment reporting.

What clients are left with is an inconsistent picture of the ratings and risk that vendors are attempting to communicate. An electric automotive company, for example, may be rated very highly for ESG on some reports thanks to its post-production impact which results in vastly reduced carbon emissions. Others might score that same company on their working practices, use of precious metals or their corporate governance, which may result in lower scores.

The focus of this article is how HSBC has explored the challenges and nuances of ESG data and devised ways in which it can be used effectively for post-trade reporting as a new Securities Services product offering. We carried out an extensive comparative analysis of sample ESG data across 20 third-party ESG data suppliers in 2018 and 2019. We were surprised by how variable the results were and took time to review the extent of ESG data difference with investment professionals from a select group of clients, based in London, to ensure we had interpreted the results correctly. This discovery of the extent of differences in ESG ratings has led to us offer a choice of suppliers within our ESG portfolio reporting product.

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## 2 > The quest for validity

For reporting purposes, then, it is clear that the non-financial world needs to catch up by putting those metrics that gauge the impact of ESG on investments on an equal footing with financial performance.

One body working to secure adequate company disclosures is the Task Force for Climate-Related Disclosures (TCFD). Chaired by Michael Bloomberg, its 31 G20 member states are working towards its stated goal of achieving “Better information [that] will allow companies to incorporate climate-related risks and opportunities into their risk management and strategic planning processes”.

At the end of October 2020, TCFD released the findings from its latest survey, which indicated that the corporate community has shown an “85% increase” in its declared support for the disclosure recommendations over 2019 – though much work is still needed to be done. And while those sectors leading on disclosure – energy, materials and buildings companies – average between 30% and 40% in their TCFD-aligned reporting, there is a notable majority that are yet to disclose at all. Asset managers and owners are therefore still faced with insufficient reporting as a result. TCFD is also currently consulting on a potential forward-looking climate measure called Implied Temperature Rise which is intended to gauge each company’s transition path towards UN Paris Agreement targets.

Given the high degree of focus on ESG investments, the percentage of large companies disclosing greenhouse gas emissions should be heading towards 100%. However, despite this gloomy sounding background, businesses are waking up to the seriousness of ‘valid’ and transparent disclosure processes. Among a range of regulatory frameworks being progressed, the EU consulted in 2020 on a harmonised reporting template, which details 50 adverse sustainability indicators. Regulators in Asia, such as the Hong Kong Monetary Authority (HKMA) and Securities and Futures Commission (SFC) in Hong Kong, and the Monetary Authority of Singapore (MAS) in Singapore, are also consulting on ESG regulations.

In October 2020 HSBC launched the results of its annual Sustainable Financing & Investing Survey, which went out to 2,000 Issuers and Investors across 34 countries. The results indicate increasing levels of disclosure: In

2020, 46% issuers expected to increase current levels of disclosure, either through their own initiative or to satisfy demands from investors or regulators, up from 42% a year before. In 2020, 35% of investors disclosed the ESG characteristics of their entire portfolios, which is up from 24% in 2019.

We are now at a tipping point where we have the historic, investment-led, information – but companies are increasingly expected to disclose carbon emissions and commit to reduction targets. The factors surrounding ESG will become increasingly available as disclosure increases. We intend to support our clients by providing ESG data – once available – that will help them measure the achievements of their ESG policies and to meet regulatory obligations.





## 3 > A toolbox for clients

How, then, can clients gain insights that measure how their investments are performing, in terms of ESG, over the long term? The answer lies in providing periodic portfolio reporting from a choice of established and recognised ESG data providers, therefore making a broad range of information available to them.

We know there is no time to lose, and it could take years for new and consistent data to become widely available. In the meantime, we have devised a way to provide periodic reporting using existing ESG data in the way that it's intended.

Based on the Bank's own experience of clients' expectations, a 'good' company needs to balance out a number of nuanced characteristics that span an enlightened management regime, strong environmental and social policies, a motivated and fairly treated workforce, and compelling evidence that they can maintain resilience and sustainability, such as the current pandemic.

Individual providers – whether coming from MSCI, Sustainalytics, VE, ISS, FTSE, Refinitiv, Bloomberg, Reprisk or TruvalueLabs, amongst many others – offer very different methodologies to measure the ESG factors of investee companies. HSBC has countered this by embracing the range of different ESG information and offering clients a product that can provide reporting from three leading ESG providers – therefore maximising transparency.

Our ESG portfolio reporting product offers a choice of leading ESG data providers so that the differing results can be easily compared, to provide meaningful insights for our clients. We offer reporting based on MSCI, Sustainalytics and VE, providing separate reports for each, with an overall portfolio score and tables of large positions. The reports use an identical layout for each data provider, so the results can be compared, tracked month-to-month and used as a means to challenge the investment decisions. Large positions in each portfolio are displayed according to high and low ESG scores, as well as those with highest carbon emissions.





## 4 > The time to act is now

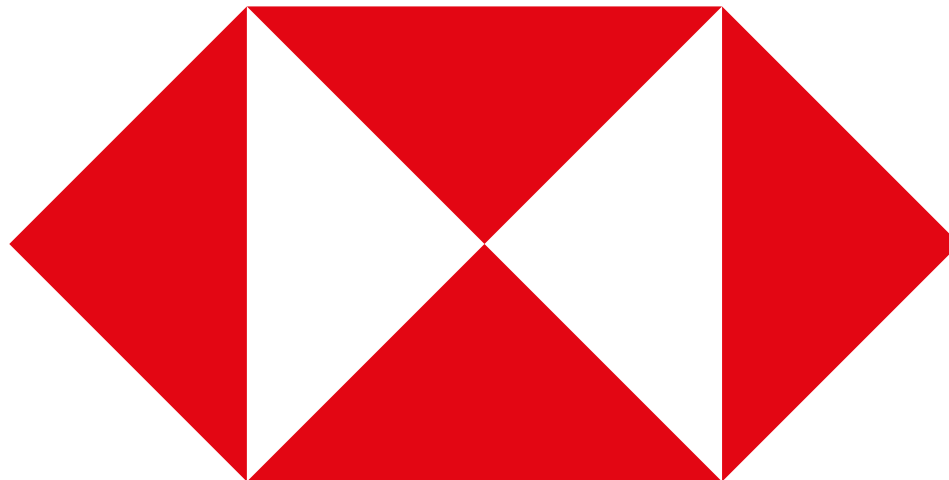
The pandemic in 2020 has served to move ESG towards the forefront of investment strategies; the heightened emphasis on Social factors in particular has helped to 'raise the bar'.

There are some excellent initiatives, with several mentioned in this article, designed to deliver ESG and climate data that will help underpin and direct the large amounts of capital that is necessary to achieve sustainable investment and impact outcomes, and HSBC supports these fully. However, the time to act is now: our ESG reporting product is designed to maximise the value of ESG data already available to instill urgency in tackling the climate change emergency. We are providing meaningful contemporary insights to help promote improvements in corporate practice, behaviours, data accuracy and increased harmonisation of the metrics. HSBC's ESG portfolio reporting service doesn't shy away from outlining what action and engagement our Securities Services clients might need to take; it is both meaningful and designed to make a tangible difference.

The more disclosure that takes place, the better the information will be for all.

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