ESG integration

Failure is not an option – Technology is the only answer!

The ESG tributary is fast becoming the mainstem when it comes to investment flows. Technology will play a pivotal role in supporting this transformation and enabling competitive advantage.

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Contributed by Alan Goodrich, ERI

Blackrock CEO, Larry Fink, has famously written that, "climate risk is investment risk". He has also framed the climate transition as a "historic investment opportunity."

It is estimated in the market that over USD 40 trillion has already been committed into funds and companies in the ESG space. This is projected by some to reach USD 140 trillion by 2025, i.e. 1/3 of all AUM. This is a shift in the sand that cannot be ignored, even if the impact has yet to materialise.

Regulators, such as the SEC, could soon make ESG performance reporting obligatory for market participants.

Technology is going to play a pivotal role. New processes and data will need to be embraced throughout the investment lifecycle in order to support this transformation and enable competitive advantage, for example:

- Client suitability tests
- Incorporating ESG into portfolio construction
- ESG reporting
- News & analytics
- Reliable ESG data to make investment decisions

Investment funds that used ESG principles captured an estimated USD 51.1 billion new money in 2020 – a 140% increase on 2019. This is only expected to increase further as the great wealth transfer proceeds, anticipated by some to account for USD 30 trillion changing hands over the next 20–30 years.

The younger generations are either more willing to align their values with their investments, or more open to change. Either way, the industry must adapt to both supply and demand-side needs.

However, there is work to be done in order to establish trust in the definition of ESG. The high level EU action plan on financing sustainable growth, new regulations including SFDR, NFRD, FRIB and EFDR, as well as the adaptation of existing regulations such as MiFID II, IDD, CRD and many more, may help achieve this, but they also add to a compliance burden that is already weighing heavily on the profitability of the financial services sector. Generally, technology is the only way to minimise and cost effectively share this load.

Systems need to facilitate access to transparent and standardised ESG data, presented meaningfully for both investment professionals and clients alike, so that a common understanding and education as to what ESG really means is achieved. The applications used to manage the investment process, both pre- and post-trade need to be ready to capture and monitor ESG preferences or constraints defined by the client, the prospectus of the investment vehicle, the regulator, and the risk managers (not to forget Larry Fink's point).

Implementing technology that simplifies and streamlines the hidden complexities embedded in ESG investing will undoubtedly provide the potential to create competitive advantage, both by attracting new assets while cost-effectively and compliantly processing the transactions, managing the portfolios and reporting to the regulator(s).■

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