IFI Global

This is an extract of The ESG Report May 2023 featuring RiskMonitor's ESG Solution, not for general distribution

The ESG Report

ESG risk measurement

Risk in environmental investing is a growing concern for fund managers. Sustainable investment objectives can no longer just be aspirational; they actually have to be met.

Bloomberg, amongst others, says that greenwashing remains the biggest threat to the future of ESG investing. It believes that to be the case even though there has been a considerable effort made to crackdown on it over the last few years. In the US that has mainly been through litigation whilst the focus in Europe the has been on regulation, principally through the SFDR.

Litigation risk, in particular, is becoming an ever-growing threat for fund managers. As mentioned in the interview with Bob Swarup in this issue (see page 9) there are approximately 2,000 cases going on around the world at present connected to climate litigation.

To make sure that ESG funds are keeping to their environment pledges there are more and more litigation funds being launched. One of these, from Aristata Capital, is backed by Soros Economic Development Fund.

Solutions are being developed for asset managers, to counter the growing regulatory and litigation risk around ESG. They are intended to make sure that managers can demonstrate compliance with the

sustainable investment objectives that are being promoted by their funds, for example the UN's Sustainable Development Goals (SDGs) or the six environmental objectives for the EU taxonomy alignment.

One of these solutions, RiskMonitor ESG is being launched by MJ Hudson Quantitative Solutions (formerly Clarus Risk). The ESG Report spoke with Max Hilton, Managing Director of MJ Quantitative Solutions, and Maria Palazzi-Nieves, Data Scientist and responsible for the development of RiskMonitor ESG.

Maria Palazzi-Nieves says that their aim is to develop a concise reporting solution that provides metrics and visualisations to evaluate sustainable goals across different performance indicators. These include forward-looking metrics such as the temperature scoring methodology developed by the Science Based Targets initiative (SBTi). The solution allows asset managers to assess whether their funds are meeting their goals. RiskMonitor ESG tracks trends over time, such as carbon footprint, or temperature alignment, and can provide insight into the extent to which ESG objectives are being incorporated into an investment process.

RiskMonitor ESG is customisable, allows managers to demonstrate compliance with ESG objectives and versus peers or selected benchmarks.

On launch, the solution will focus on traditional asset classes such as bonds and stocks, but it will soon incorporate more complex asset classes such as derivatives and private debt. It will therefore be a tool for hedge fund and alternative managers, as well as long only ones.

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ESG risk measurement

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Maria Palazzi-Nieves says that the major challenge to date has been ensuring sufficient data quality. They need reliable data from underlying portfolio companies as well as funds to provide accurate results. Particularly, in terms of GHG indirect emissions data (scope 3), it is important to highlight that in many scenarios analysis is based on estimated data. If such data come from different sources, employing different estimation models, they need to ensure that estimations are consistent.

She adds that a big concern for boards is that funds' ESG policies are fit for purpose. To do that they need to be properly tested on a regular basis. That is what their solution seeks to address. Boards can use their service to demonstrate to investors and regulators that ESG policies have been independently tested and verified. Without sufficient transparency investors may not allocate and nor will funds be distributed for fear of running fowl of the SFDR.

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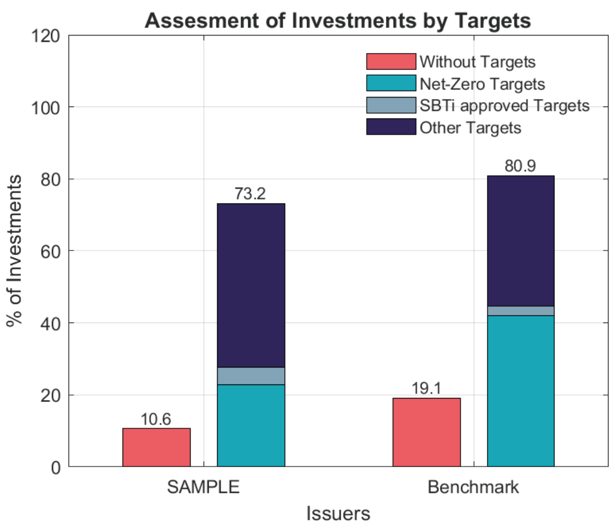
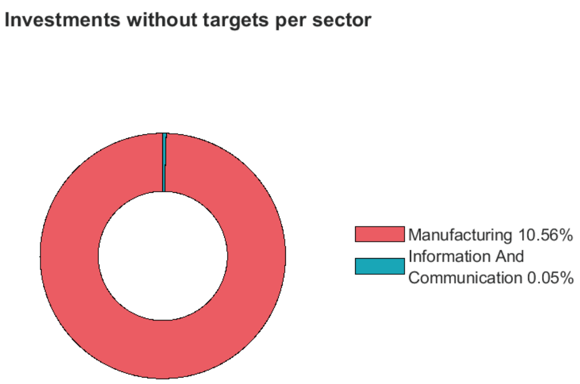
While RiskMonitor ESG service is primarily intended for fund managers falling under SFDR's Article 8 or 9, it will also be valuable for funds outside the SFDR scope e.g., Article 6 or 0. It supports portfolio management teams and aims to give boards and senior management confidence by independently measuring a growing suite of ESG indicators.

Illustration of how RiskMonitor ESG figures are shown in reports:

Assessment of Emission Reduction Targets

Left chart shows the proportion of portfolio investments in assets with and without defined emissions reduction targets. Right chart shows the distribution of assets without targets classified according to their NACE sector. **10.60% of the portfolio investments are related to assets within emission reduction targets**





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ESG risk measurement

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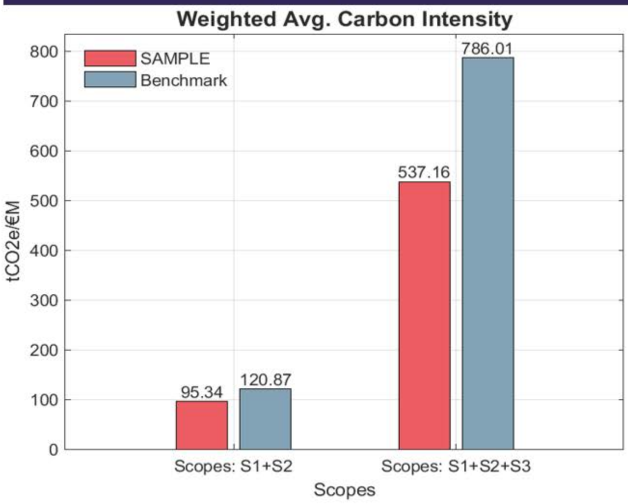
The figure on page 13 shows:

1. an assessment of investments with or without GHG emissions reduction targets for a sample portfolio and benchmark,
2. A breakdown of the targets as whether they are net-zero or SBTi approved, and
3. the proportion of investments without targets according to their NACE sector.

Weighted Average Carbon Intensity



Scope	Issuers	% Contribution
S1+S2	L'AIR LIQUIDE SOCIETE ANONYME	40.90
	SOLVAY SA	21.70
	COMPAGNIE DE SAINT-GOBAIN SA	4.96
	Taiwan Semiconductor Manufacturing Co.,	4.75
	Gerresheimer AG	4.57
S1+S2+S3	L'AIR LIQUIDE SOCIETE ANONYME 2	14.40
	SOLVAY SA 2	10.10
	Neste Oyj	8.30
	ASML Holding N.V.	5.57
	Sociedad Quimica y Minera	4.90

Left chart shows the weighted average carbon intensity of the portfolio in tCO_2e/€ M of revenue plotted against benchmark. The portfolio's Weighted Avg. Carbon intensity is 21.13% lower than the benchmark. Table above shows the top five issuers with the largest contribution to portfolio weighted average intensity.

This figure shows the weighted average carbon intensity of a sample portfolio in tCO2e/M€ of revenue against a selected benchmark, and the top five issuers with largest contribution to portfolio weighted average carbon intensity. ■