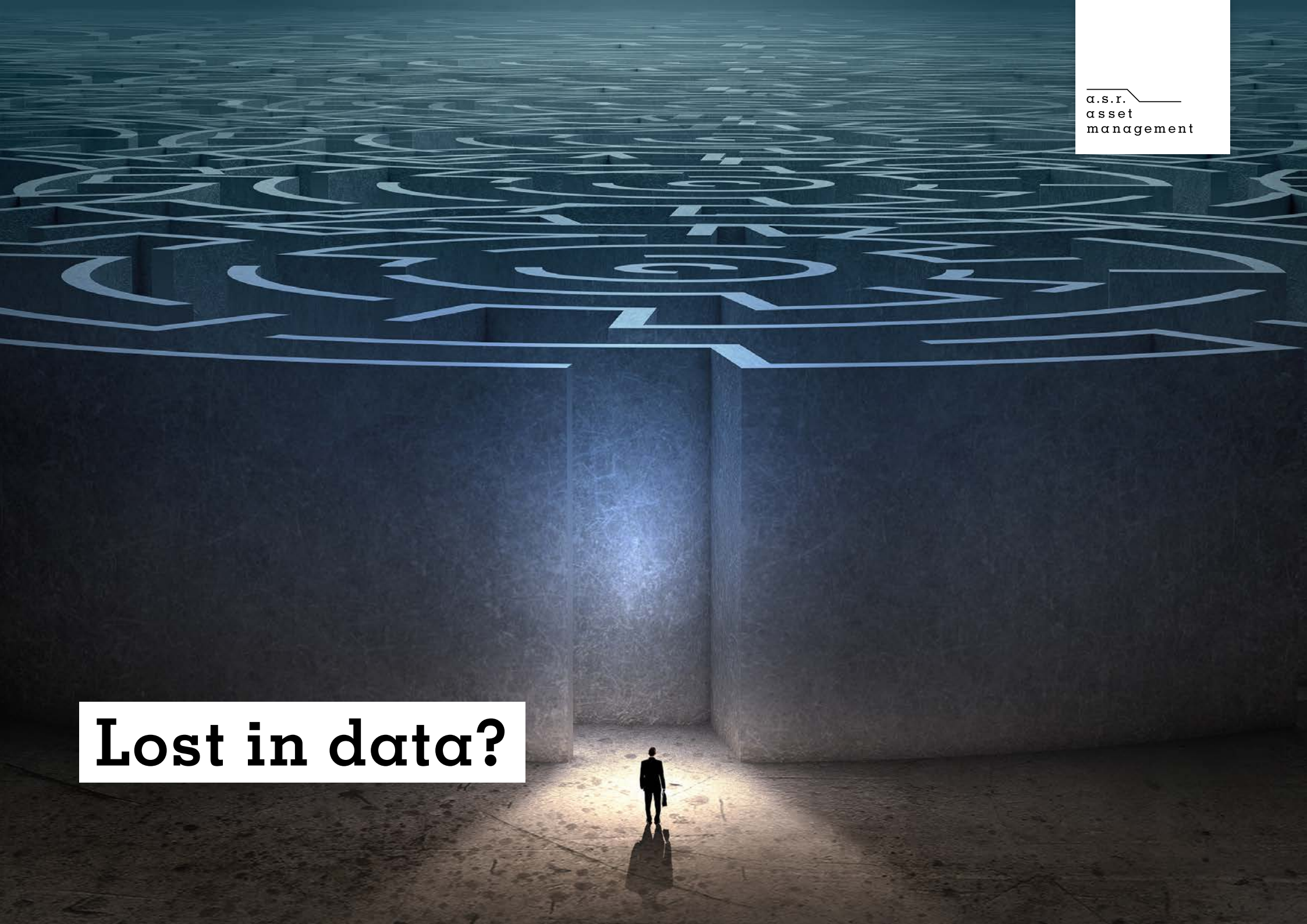
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Lost in data?

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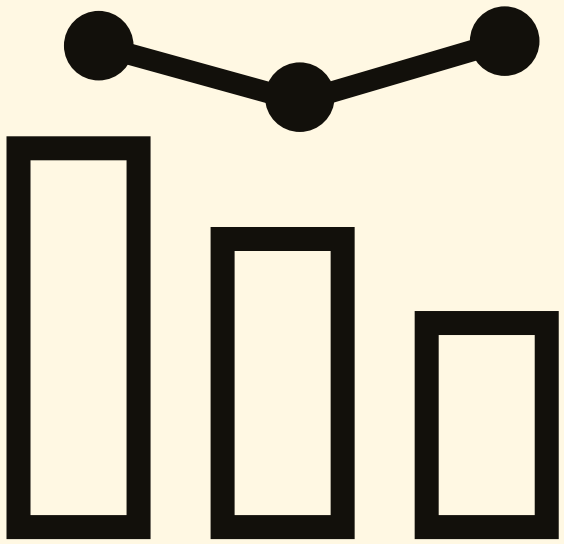
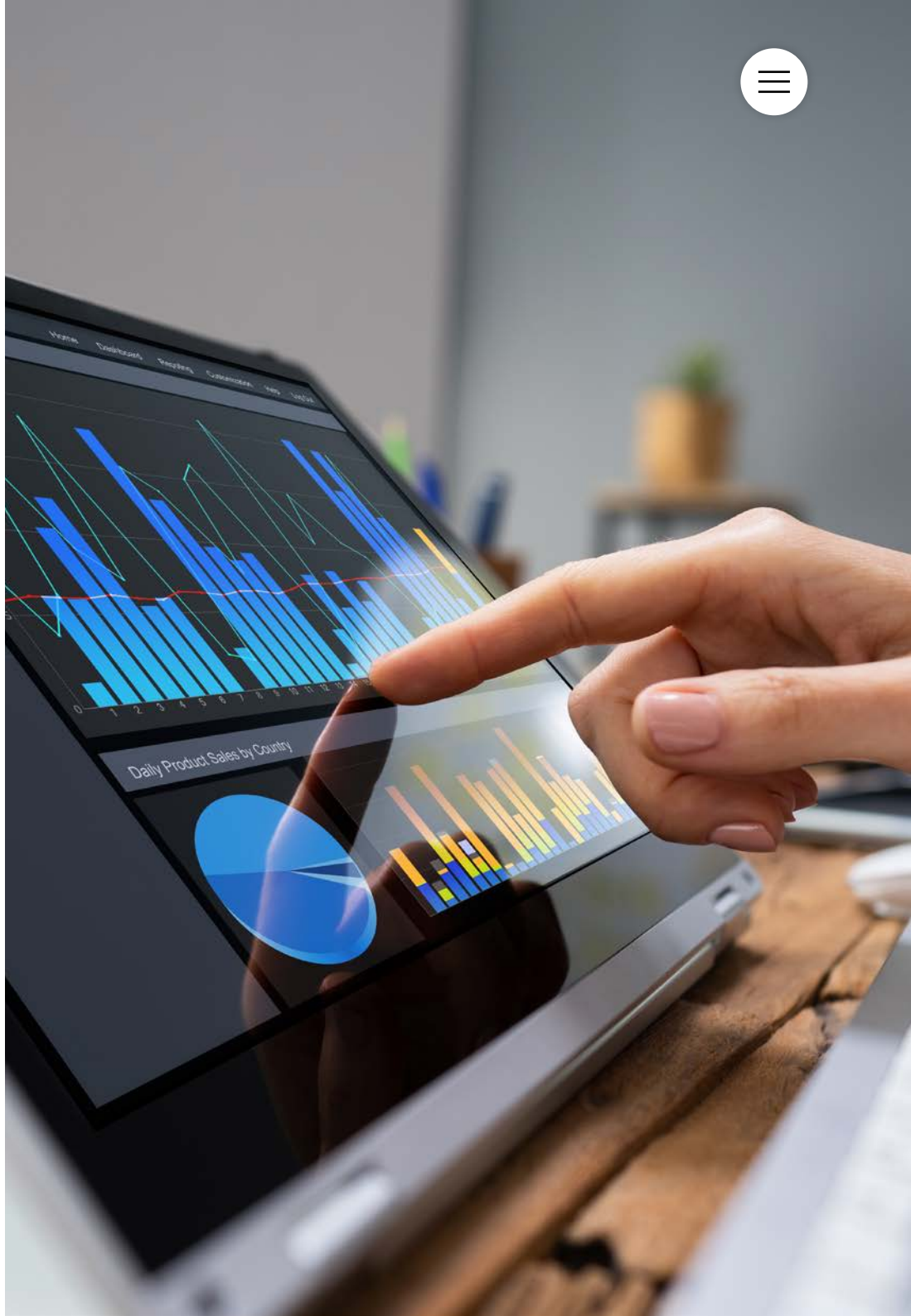


Lost in data?

In a previous paper we left the reader with the question on how to use data to drive investment decisions. Data on sustainability performance of investee companies, or better yet, data on future ambitions and associated capital investment plans. Or, taken to the level of a sovereign issuer, data on the wellbeing performance of a country and all its inhabitants, and data on national or supranational investment priorities.

There is no shortage of data, and data providers, available to institutional investors. Each providing a slightly different lens or built on a slightly different evidence base. It is no wonder that the profession of ESG data scientist is a growing area of interest and need. Tracking and communicating the many ways in which investors can assess sustainability performance is a full-time job for many people. Abbreviations and nomenclature such as SBT's, TCFD, PCAF, PBAF, PACTA, SDG's, EUT or DNSH have all become part of the ESG professionals' vocabulary in 2021.

But does what gets measured also matter, and are we measuring the right things if the aim is to 'invest in the winners of tomorrow'? Within the growing realization that the winners of tomorrow will not be assessed by the rules of today, but will operate in an environment in which negative 'externalities' (such as greenhouse gas emissions leading to anthropogenic climate change, air pollution, biodiversity loss, but also health issues due to excessive sugar consumption or rising social inequalities) will be increasingly priced in to the production (or consumption) of a good or service?



Give me data!

The traditional way in which ESG data service providers operate is to mine as much of the public space as possible, through data aggregation or approximation models. Data points are collected – if we limit ourselves to the ESG space – from company's annual reporting suites (Annual Reports, Financial Results, SEC Filings, Investor presentations, AGM transcripts, Sustainability Reports) but also submissions to voluntary reporting initiatives such as the CDP (for performance on climate change, water or deforestation) the UN PRI or the UN Global Compact (through the Communication on Progress) or from popular traditional and social media channels, including opinions from civil society organizations.

Results are then analyzed and assessed according to various industry specific materiality principles or standards (using frameworks like SASB or GRI) and given weighting based on a variety of considerations (such as whether data points were assured by an independent third party).

Institutional investors can use the end results as input to assess and compare the ESG performance of companies. Which can work but can also lead to much discussion and counterintuitive results[1]. This may then result in the question whether we should use multiple ESG data vendors to smooth out the variance and volatility – resulting in higher costs to the investor – or find another, uncorrelated source of data to complement an existing approach?

We say complement as this is not a zero-sum game. ESG data and non-financial reporting is important, and its evolution is speeding up through various legislative steps taken by national and supranational governments or regulators in recent years.

1 FTSE 100 – the 5 highest ESG rated companies https://www.hl.co.uk/news/articles/ftse-100-the-5-highest-esg-rated-companies [3 March 2021]

What about your uncorrelated data?

New Zealand was the first country to mandate climate risk reporting for its business community and financial market participants in 2020, and the United Kingdom will follow suit in 2023-25. Germany recently adopted legislation (after France led the way) that will force companies to assess and disclose human rights' violations in their supply chains, starting in 2023. And the EU is working through mandating companies in all member states to report against a large amount of climate-related and non-climate related sustainability indicators through its newly proposed Corporate Sustainability Reporting Directive (CSRD).

At the United Nations level, a framework was recently adopted for sovereigns to start reporting on their natural capital dependencies and impacts in a standardized way through their economic reporting processes, while in The Netherlands the national bureau of statistics leads on annual wellbeing and SDG measurements to support policy decisions[2].

Even in the United States, during the first days of the Biden Presidency, various positive steps were taken to increase disclosure on ESG and allow ESG considerations back into investment decisions at the Federal level[3] - which would suggest rapid developments until at least 2024.

All good developments that will – hopefully – improve data quality on ESG performance of companies and countries in scope of these regulations and frameworks.

2 Monitor of well-being & the SDGs 2020 https://www.cbs.nl/en-gb/publication/2020/21/monitor-of-well-being-the-sdgs-2020

3 ESG Disclosure – Keeping Pace with Developments Affecting Investors, Public Companies and the Capital Markets https://www.sec.gov/news/public-statement/coates-esg-disclosure--keeping-pace-031121 [11 March 2021]

We have recently set out to pilot a new methodology to complement our investment process and quantify the societal impact of our investments. Teaming up with Util, a British service provider which has developed a quantification process and tool based on machine learning and Natural Language Processing, we have sought to objectively quantify the net impact of our equity and debt investments in public companies and sovereigns.

Patrick Wood Uribe, CEO of Util says:
"We've reached an important turning-point in the world of data for investors: it used to be that any new data had some information value as long as it was accurate. Now, many otherwise good new datasets either overlap, or disagree in ways that make things less clear, so it's absolutely critical that new data adds genuine new information value.
The results outlined here clearly illustrate how novel complementary datasets can bring new, constructive, information to the process".

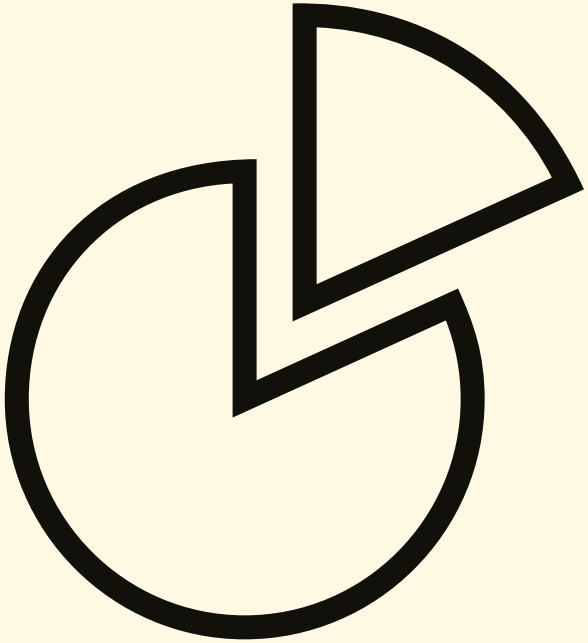
Some considerations to set the scene:

The all-important question is 'what is the evidence base'?
There is no shortage of impact measurement technology firms. Develop an algorithm and let it loose on a dataset. But you can imagine different results will be found in a data set consisting of social media inputs (or company self-reported data) as compared to a data set consisting of peer-reviewed academic articles. The correlations and causalities between (revenue derived from) products and services and sustainability concepts (should) present different levels of quality and robustness.

Can you calculate net impact?
Whether using the seventeen Sustainable Development Goals, the Planetary Boundaries or the Doughnut model (as discussed in the previous paper) the breadth of ESG or sustainability-related topics is such that a positive contribution to one does not mean an overall positive contribution. There are always trade-offs. Can you therefore quantify the nuance so you can make informed investment decisions?

Where is the impact?
When looking at traditional ESG data it (usually) compares sector peers and favors the one with higher levels of sustainability performance (or reporting). But is the real impact of a company found within its office walls, or within its products and services, as measured by the revenue derived from those products and services? How does one assess a tobacco company that increases revenue from the sale of its products, while it offers excellent paternity leave arrangements for its staff? Or a biotech company which is developing a new medicine but does not generate any sales yet?

What can you get out of the analysis?
And a final, very practical, point is, what should you expect to get out of the analysis. There is a lot of innovation in the AI and NLP space, especially in the financial sector. We see large established managers experimenting with different approaches and tooling, and the body of academic literature on AI and machine learning within asset management is growing rapidly[4]. But, especially for NLP, it is good to be clear upfront on how such a process could assist with decision making. Does it provide continuous data, will its output be sentiment analysis, or does it do topic modeling, and can you build credible new investment products on the data.



4 CFA (2020) https://www.cfainstitute.org/en/research/foundation/2020/rflr-artificial-intelligence-in-asset-management

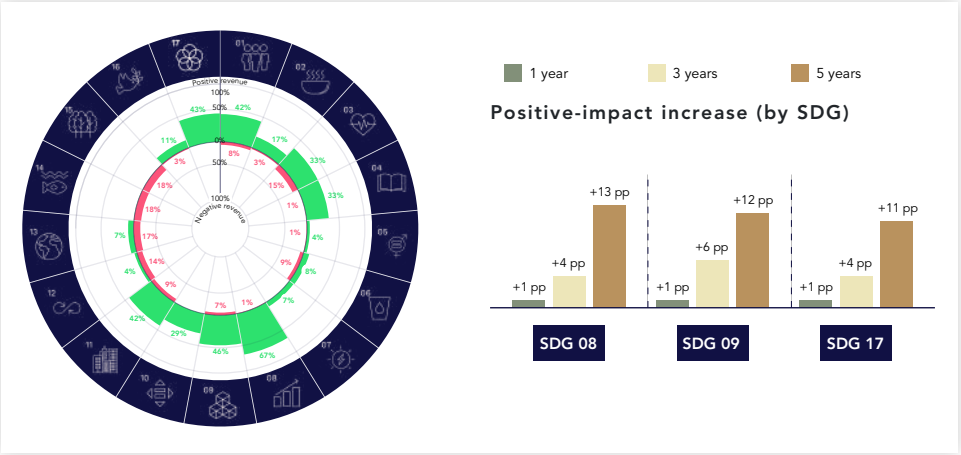
The societal impact of our proprietary assets

We invest the majority of the insurance premiums of our parent company, ASR Nederland. We mainly do this ourselves for those asset classes for which we have in house expertise (listed equities, Euro corporate bonds and sovereign debt) but also use external managers when they can offer added value. We have assessed the net impact of these proprietary assets for the period 2015-2019, using the Sustainable Development Goals as a framework and quantifying and aggregating the revenue-weighted impact of the portfolio constituents.

What the radial chart shows is the degree to which the portfolio positively and negatively aligns to each SDG. Since it is exposed to a broad range of product categories and sectors, there are instances of both positive and negative alignments. This chart is the impact for the portfolio at the end of 2019 and only covers our equity and corporate debt instruments. We disregarded our positions in government debt, instead opting to assess those separate compared to our ESG focused sovereign debt fund.

You will see a positive outperformance on most social and economic development SDG's (No Poverty, Decent Work and Economic Growth, Industry, Innovation and Infrastructure, Sustainable Cities and Communities, and Partnerships) which makes sense considering these are predominantly investments in large caps, which are large employers.

You will see less of a positive outperformance on the various environmental SDG's (Clean Water and Sanitation, Affordable and Clean Energy, Climate Action, Life Below Water, Life on Land) which also makes sense given the focus of the portfolio on established public companies in developed markets, which are – in so far as relevant for their operations, products or services, and not excluded from our investable universe – either in (much needed) transition, or in a sunset industry.



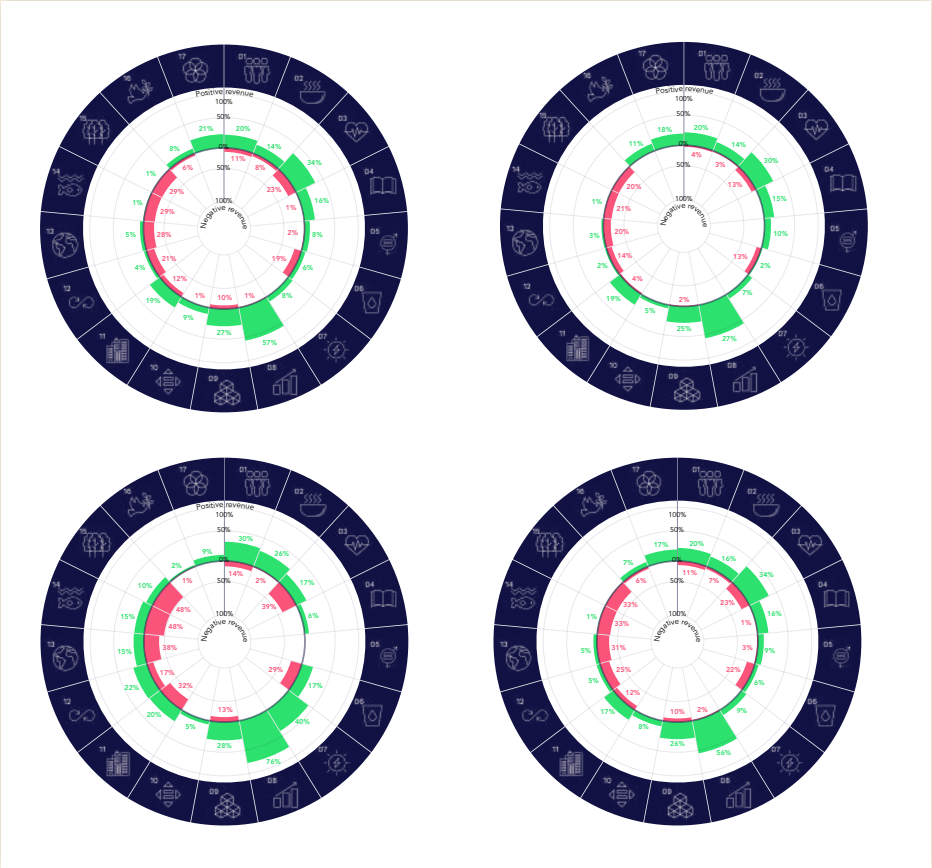
The societal impact of our ESG focused investment funds

In 2017 we launched three new investment products which focus on incorporating additional ESG considerations above and beyond the standards set within our general policy on sustainable investing. One fund in European listed equities, one fund in Euro corporate bonds and one fund in Euro sovereign debt. These three funds are managed against a benchmark, which allows us to quantify the relative sustainable outperformance of these three products against their investable universe.

European listed equities

The European listed equities fund (ISIN NL0012294144) invests in a diversified portfolio of listed European equities and follows a two-pronged approach to reach its sustainable objectives. Between 70-80 percent of the strategy is invested in a passive index-tracking core portfolio (which adheres to all applicable firm-level exclusions and policies) and 20-30 percent is invested in an active satellite portfolio.

The radial charts show the impact spread for year-end 2019 and makes a distinction between the entire portfolio (top left chart, n=389), the actively managed satellite (top right chart, n=28), an internally managed portfolio for own account, which is managed according to our impact investment criteria for listed equities (bottom left chart, n=9) and the benchmark used for the fund, the MSCI Europe (bottom right chart, n=425).



What the analysis shows above all else is that in more diversified portfolios or indices, not only risk is mitigated but impact seems to also be more diluted across the range of thematics. Concentrated portfolios will generally show more concentrated impacts, as they are selected for specific outcomes. This result seems to make the case for active management, combining more fundamental analysis, securities selection with active ownership. It also points

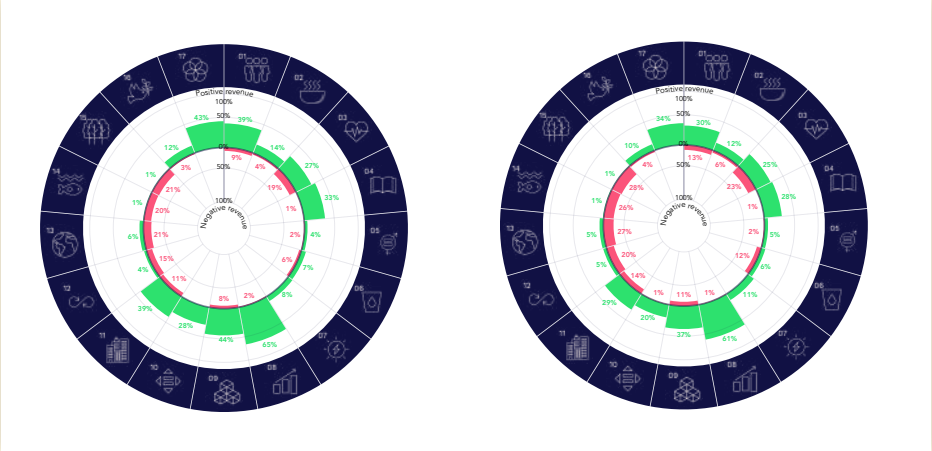
to the indirect impacts of companies, and their interdependencies within their value chain.

For thematics such as climate action and the energy transition, this type of analysis highlights the risk that exists in the market of adopting too narrow a focus on metrics such as carbon intensity, when trying to optimize for systemic themes.

Corporate bonds

The listed bonds fund (ISIN NL0012294102) invests in a diversified fixed income portfolio consisting of Euro denominated debt. It has no satellite strategy but invests all its AUM according to the ESG restrictions placed on the fund by the manager, against a benchmark. Moreover, it focuses – within the sectors in which it invests – in best in class companies.

The radial charts show the impact spread for year-end 2019 and makes a distinction between the entire portfolio (left chart, n=259) and the benchmark used for the fund, the iBoxx Euro Corporate Index (right chart, n=500).
The difference between the two charts is perhaps clearest when looking at the negative revenue alignments, which are consistently less pronounced in the ESG fund as compared to its benchmark. This could be attributed to the fact that this fund does not actively seek out to meet a sustainable objective, but rather promotes social and environmental characteristics through a stringent exclusion policy and focus on best in class companies within the geographies and industries in its investable universe.



Sovereign debt

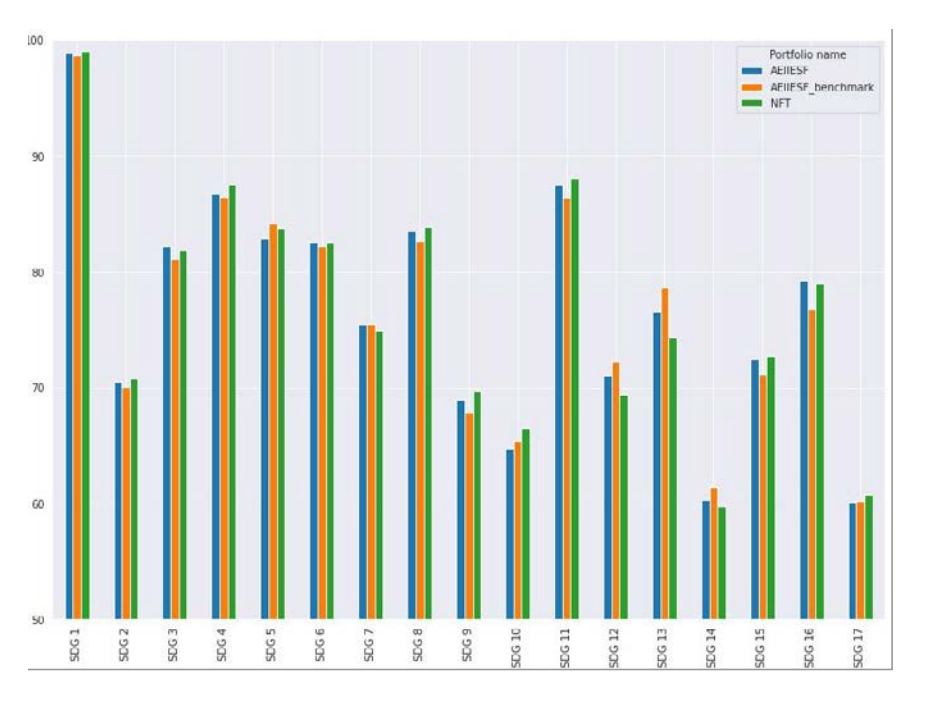
The third fund is a sovereign debt fund (ISIN NL0012294185) which invests in government bonds consisting exclusively in Euro denominated debt. It has committed itself to investing at least 10 percent of its AUM in Green Bonds and will only invest in countries that rank in the top decile of the Sustainable Development Index – as curated by the Bertelsmann Stiftung.

The Util methodology used for listed equities and bonds is based, in part, on revenue alignment with sustainability concepts. This cannot be replicated for government debt. As such, a bespoke methodology was co-developed based on various macroeconomic country scores and statistics from public sources such as the UN Global SDG Indicators Database, the SDG Index from the Bertelsmann Stiftung and other global data series on Covid-19 (Johns Hopkins University), armed conflicts and deaths (Uppsala Conflict Data Program) and obesity prevalence, life expectancy and health service coverage (WHO).

As discussed previously, similar to missing the intentionality at the company-level (potentially measured through capital investment plans) this approach for countries is somewhat static and would need to be replicated over time to find a trend in government spending and measured outcomes and impacts.

The bar chart shows the sustainability performance for year-end 2019 and makes a distinction between the ESG fund (blue bar), its tailor-made benchmark, the Q960 (orange bar) and the Euro sovereign debt within the scope of the ASR proprietary assets (green bar).

The difference between all three bars is minimal, which can be explained through the investment restrictions placed on ASR Nederland as a Dutch insurance company with liabilities in Euros, which are valued with Euro risk-free rates. There is therefore little room to invest in government debt outside of Europe, where countries tend to have high (measured) impact on the social development SDG's such as No Poverty, Quality Education, Gender Equality and Sustainable Cities and Communities. Notable lower performance is found on Reduced Inequalities and Life Below Water, the first being a frequent and visible source of debate across the continent over the past decade.



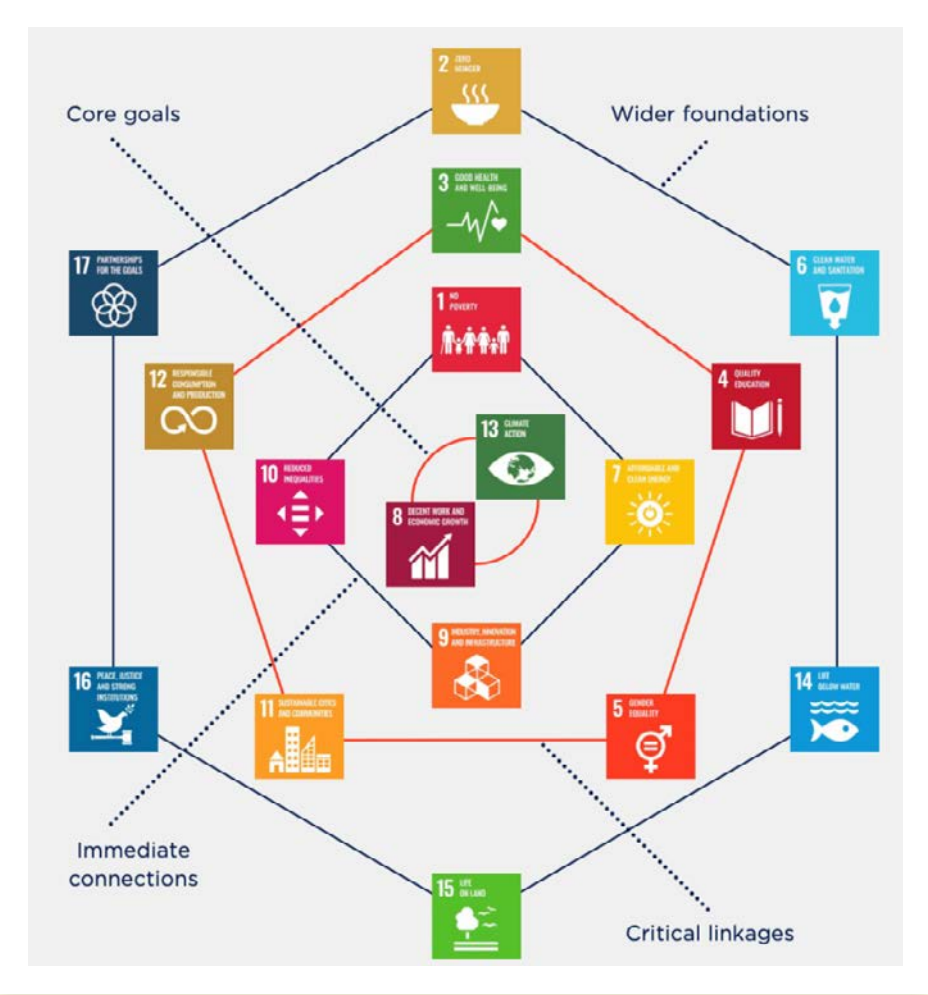
How should you interpret this?

Measuring the societal impact of financial assets and products is difficult. We all remember the lessons our high school (classical) economics teacher taught us; there are three production factors in an economy, capital being only one (the others being labor and land). Attributing all societal benefits (or costs) to the financial sector is methodologically unsound and would miss the point of intentional (or conscious) capitalism.

But an exercise like this one does provide insights into where your impact is found, and from there you can start steering to where you want it to be. ASR Nederland – as a large Dutch insurance company – has placed priority on SDG's No Poverty (1), Good Health and Well-being (3), Affordable and Clean Energy (7), Decent Work and Economic Growth (8) and Climate Action (13). It stands to reason its assets should be invested in line with these thematics as much as possible.

And they are. And moreover, using this new source of data, we find that we are doing better than the benchmark, while also pointing out very clearly the areas where further improvement and optimization is possible.

Furthermore, the chosen focus thematics align perfectly to the concept of a Just Transition – which was initially coined by the trade union movement in support of the Paris Agreement to balance climate action with social inclusion, and has since been adopted as part of the EU's Green Deal.



What's next?

But the tooling is not perfect. Like traditional ESG data it will not present a silver bullet to investors. It can't. Scientific consensus on causalities or correlations might change over time and intentionality at company- or country-level on priority societal issues will surely follow.

More practically, can we quantify potential impact of a new business or business line before any revenue is even generated (or measured). On climate there are frameworks that categorize solutions[5] but what about other areas? And how does an investor – if he or she wishes to – identify an opportunity and quantify the potential impact premium, alongside the risk profile of the investment, before making the transaction?

And what about other asset classes? Real estate, mortgages, private markets, commodities. All large markets, with positive and negative societal impacts to be measured and managed.

We will be reviewing the lessons learned through this process with a view to further optimize our investment process to create the most sustainable impact.

Raquel Criado Larrea, Head of Sustainable Investments at a.s.r. Asset Management says:
"This pilot with Util, and its results, has given us additional insights into the societal impacts of our investment products and portfolios. We all know we are in a transition to a more sustainable economy and society, and we need innovative thinking to bridge the gap between providers of solutions and the investment community. We continue to contribute where and when we can to align financial and societal returns".

5 Project Drawdown curates a database on climate solutions https://www.drawdown.org and the EU has started setting thresholds for various economic activities and their contribution(s) to climate change mitigation and climate change adaptation targets, through the EU taxonomy for sustainable activities

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