In search of quality ESG data

An investment view on corporate sustainability disclosures

Companies continue to improve their disclosure of sustainability matters that are critical to their business. As investors, we welcome this development as we increasingly pay attention to companies' disclosures in our integrated approach to sustainable investment. We look to discover whether companies are running their business with the future in mind and to assess how environmental, social, and corporate governance (ESG) issues could affect their financial performance.

There is no doubt that companies have noted this attention from investors. We also see that company-disclosure efforts have become more ambitious, driven not only by investor demand, but also by regulation and increasing societal expectations.

While the field of ESG disclosures has progressed over the past years, it is also an evolving landscape. Since we believe that better data will give us better insights and help us to make better investments, we want to support and contribute to how companies can further improve their ESG disclosures to investors. In doing so, we have analysed the 100 largest listed Nordic companies' sustainability disclosures and its usability in our investment processes. We found roughly 21,000 data points from the companies, of which 1,000+ were overlapping, resulting in some 20,000 unique data points to evaluate.

In this publication, we share our research findings and our four priority areas to promote and support companies in their efforts to provide standardised ESG disclosures that we can use in our investment research and decision-making, namely: financially material; comparable; accessible; and reliable.

Our sustainable investment strategy 'ESG Inside' highlights our focus on integrating ESG as a factor alongside financial factors in our investment processes and decision-making. For this, we need quality data about topics that could affect company performance, a concept known as financial materiality. Financial materiality is our lens for ESG integration and we use Sustainability Accounting Standards Board (SASB)* and their materiality map across sectors and industries. Our focus on financial materiality allows us to bridge business and environmental and social impacts and turn noisy data into actionable insights. It also helps us contribute to a positive impact on business and society through dialogue and active ownership, while delivering value to our customers.

Supporting this journey for better quality of ESG data and corporate disclosure requires a collaborative effort that involves investors, companies and policy-makers. As an investor, we also seek to contribute to stronger disclosure frameworks and look forward to discussing and sharing our initiatives and insights into sustainability disclosures that are financially material, comparable, accessible, and reliable.

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** https://www.sasb.org/*

FACT BOX: Financial materiality and Environmental & Social materiality

Financial materiality
A concept that explains how Environmental, Social, and Governance (ESG) issues can affect a company's business model or value-drivers, e.g. revenue, costs or asset value. For ESG issues to have financial impact, it must have an affect on a company's cash-flow or cost of external financing. Financially material ESG issues differ between companies depending on the company's business and industry. The Sustainability Accounting Standards Board (SASB) industry-based standards provide a framework to understand which ESG issues are material to companies in different industries.

Environmental & Social materiality
A concept that explains the social and environmental impacts (also known as externalities) arising from a company's activities that are borne by others. It highlights that the external costs that companies give rise to via their business operations could be material for civil society stakeholders, such as employees, consumers, governments but also investors. Climate change is one example of an environmentally material issue that is becoming increasingly financially material.

Exhibit 1

Overview of research scope: Top 100 Nordic listed companies

	Total	Denmark	Finland	Norway	Sweden
Reports analyzed	100	22	17	14	46
Data points	20,790	2368	5501	3434	9487
Average data points	208	108	324	229	206
Environmental data points	36%	35%	33%	29%	40%
Social data points	47%	48%	49%	55%	43%
Governance data points	17%	17%	18%	16%	17%

Source: Top 100 Nordic listed companies' sustainability reports, annual reports, integrated reports, etc

White spaces in Nordic companies' sustainability disclosures

Sustainability disclosures are still largely voluntary, and companies can align themselves with different reporting initiatives, depending on their preference and which stakeholders they prioritize.

The reporting menu includes a number of different global initiatives, frameworks and standards as outlined in Exhibit 2. These initiatives all emphasize different objectives and areas of sustainability reporting. Early initiatives, such as Global Reporting Initiative (GRI) and Carbon Disclosure Project (CDP), focus on externalities, such as social and environmental impacts arising from the activities of a company that are borne by others. Indeed, externalities have been a focal point of sustainability reporting since the late 90's, when stakeholders and governments began urging companies to disclose their impacts on society and the environment. Conversely, Sustainability Accounting Standards Board (SASB) and International Integrated Reporting Council (IIRC), focus on financial materiality, i.e., sustainability issues that may affect a company's financial performance.

Nordic companies have been early adopters of reporting frameworks, and have established a good reporting structure. 80% of our research sample is aligned with at least one reporting initiative. While the ambition is good, it has created a legacy of focusing on externalities rather than financial materiality. This, combined with the use of many different reporting practices, makes it a challenge for us to identify what is important for the company, to compare the company with its peers, to extract the data in an efficient manager, and to verify the reliability of data.

To solve for this, we have identified four areas of priority to promote and support companies in their efforts to provide standardised ESG disclosures that we can use in our investment research and decision-making:

1. Financial materiality: Data that reflects what is important for the company.
2. Comparability: Data that is comparable across companies and industries.
3. Accessibility: Data that is accessible to investors in different formats.
4. Reliability: Data that has high quality assurance.

Exhibit 2

Adoption of reporting initiatives with focus on Financial materiality or Environmental & Social materiality

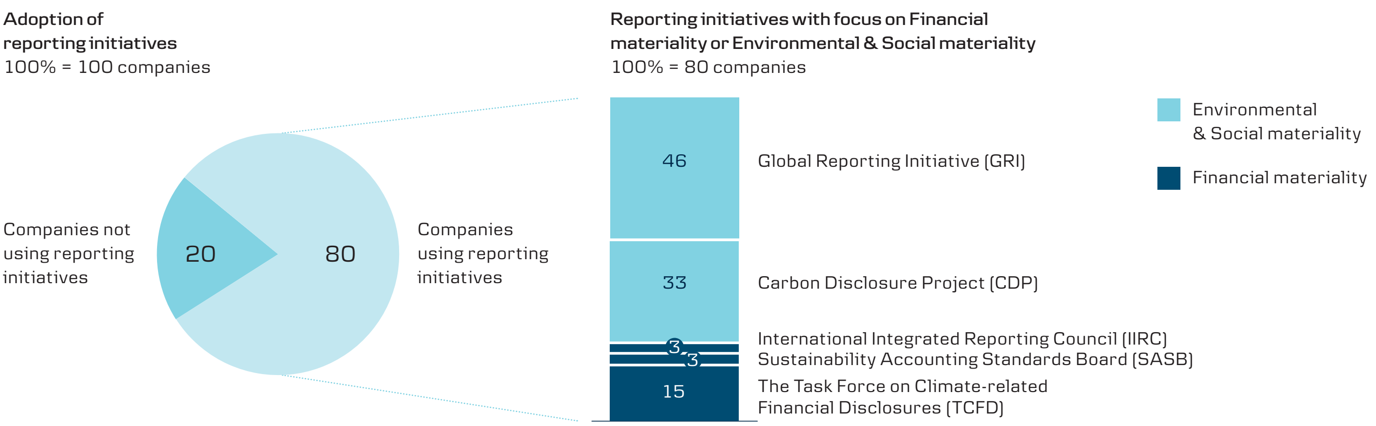


Exhibit 3

Criteria supporting investment-relevant sustainability disclosures

	Criteria	Main findings
1 Financial materiality	Data needs to reflect what is important for the company	• Companies substantially **over-report on non-material information** and **under-report on material information** • Companies in **challenging ESG sectors** have better coverage of material issues
2 Comparability	Data needs to be comparable across companies and industries	• **Comparability is challenging due to three main reasons** • Many company specific disclosures • Ambiguity and scope mismatch of disclosures • Lack methodological alignment and transparency
3 Accessibility	Data needs to be accessible to investors in different formats	• **Data collection** and processing **requires significant investment** in analyst hours
4 Reliability	Data needs to reflect what is important for the company	• **Data reliability is hard to consistently infer – assurance scope varies significantly between companies**

Financial materiality: Data that reflects what is important for the company

While companies provide an abundance of sustainability-related information, less than one-third is financially material according to our research and the SASB (Sustainability Accounting Standards Board) Materiality-map*. In other words, we are not able to use the vast majority of reported information in our investment research and decision-making.

While the remaining one-third that covers material data could be enough, our research finds that only 17% of the companies have full coverage of material topics that could affect their financial performance. This is a challenge, as the remaining 83% have white spaces, leaving us blindsided to how they may be exposed to key sustainability issues.

While companies on average underreport on financial materiality, some stand out on a sector basis. Companies in sectors such as Extractives & Minerals processing and Renewable Resources have a long-standing dialogue with investors around their material ESG risks, which is usually core to understanding the business case.

Conversely, our research finds that other sectors stand out for their underreporting. These include for example, the Financial and Health Care sectors. According to SASB, these sectors have risk exposures in the social capital and governance areas. These areas merit consideration from both a business and social equity point of view, as they span across the following: Data security & privacy, Competitive behaviour, and Systemic risk management practices.

Fortunately, several companies are showing signs of adopting the concept of financial materiality. 62% of companies did their own materiality assessments during 2018. While it can be challenging to understand companies' internal assessments – few companies have adopted a common taxonomy – our research found evidence that companies undertaking such assessments, showed signs of increasing relevance of data for investors. It is likely that companies that go through the process of interlinking financial performance and sustainability are better at reporting on topics relevant to investors. Indeed, average coverage of financial materiality was 14 percentage points higher for companies who conducted a materiality assessment than for those who did not.

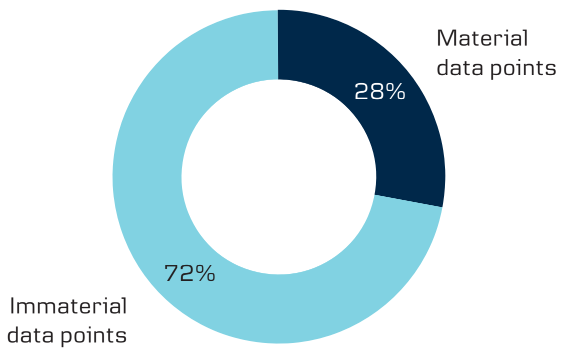
A key question regarding materiality concerns risk exposure. With a good understanding of which ESG issues that could affect a company, we do not know the extent of the potential impacts. This has a two-sided effect. First, companies may carry risk that we currently cannot price, based on sustainability disclosures alone. Secondly, companies may have hidden opportunities, which we as investors are not able to identify.

** https://www.sasb.org/standards-overview/materiality-map/*

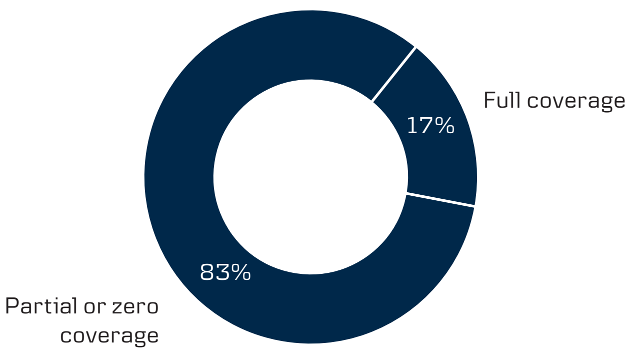
Exhibit 4

Share and scope of financially material ESG data points

Share of reported material ESG data points
Percent, 100% = 20,790 data points



Scope of material ESG data points
Percent, 100% = 100 companies



Comparability: Data that is comparable across companies and industries

While both depth and breadth of available sustainability data have increased over the years, intercompany comparability remains elusive. Our analysis shows that comparability of data is impeded due to three main reasons. First, specific disclosure items are to a large extent company specific. In practice, this means that we are not able to compare companies simply because other companies do not report on the same topics – even for companies within the same sector and industry. Across our research sample, this is the most pressing issue and reduces our comparable dataset by half on average.

Secondly, even when companies report on the same sustainability topics, comparisons are not possible as data is fraught with scope mismatches. This reduced our comparable dataset by 37% on average, as data is either too generic or too specific, to lend itself to comparison.

Thirdly, our research shows a lack of methodological transparency and alignment between companies. There is a large variation between how companies measure variables.

While there is different views on methodological best practices for measuring sustainability issues, it is important to note that standards do exist. Several reporting initiatives have made great strides in developing tailor-made standards for different industries on how to measure impacts. The issue is that these are not widely adopted by companies in the same industries. Indeed, as companies can choose reporting initiative, disclosures tend to differ in terms of methodological basis depending on each company's reporting initiative affiliation. In addition, reporting initiatives vary in terms of prescriptiveness, and companies seems to predominately lean into initiatives that offer more freedom in coming up with their own numbers.

Ultimately, it is an issue of complexity. With the many different reporting initiatives, most of which are largely unaligned on both scope and purpose of reporting, the complexity of the reporting landscape compounds the comparability issue. In order to integrate sustainability data into our investment processes and decision-making, we look for quality data for broad comparisons.

A minor consolation is that comparability can increase, partly facilitated by third-party data providers. This comes, however, at the expense of accuracy as third-party data usually rely on subjective methodologies and extensive estimation to cover missing data fields. Moreover, third-party data providers can actually compound the focus on the wrong issues, as their focus historically have not been on financial materiality. Companies, seeking good scores from rating agencies, risk being driven towards excessive reporting to avoid becoming penalized in the scoring process.

Exhibit 5

Comparability of data based on samples of standardized data points across sectors and sustainability dimensions

Sector	Sustainability dimensions*	Total number of data points	Comparable data points % of total	Comment
Extractives & Minerals Processing	Environment	678	11	Medium comparability mainly driven by scope mismatches
Food & Beverage	Social capital	206	2	Low comparability mainly driven by company specific disclosure items
Infrastructure	Human capital	671	5	Low comparability largely due to scope mismatch
Technology & Communication	Business model & innovation	173	1	Low comparability mainly driven by lack of standardized methodologies
Resource transformation	Leadership & Governance	227	7	Low comparability mainly driven by company specific disclosure items

** Sustainability dimensions defined by SASB*

Accessibility: Data that is accessible to investors in different formats

While many questions can be raised about the quality of sustainability data, one main challenge with deploying it concerns its accessibility. In order to integrate companies' sustainability data, the actual data sourcing needs to be instantaneous. Currently, companies' self-disclosed data is only accessible if investors go to search for and collect it.

This can be partly due to the multi-purpose of disclosures. Companies present their sustainability disclosures in many different ways and on different platforms, in order to provide a narrative targeting several audiences and stakeholders. If companies clarify the purpose of its sustainability disclosure and distinguish between financial materiality and environmental & social materiality, the disclosure would reach its different stakeholders more efficiently. Accessibility also covers the format of disclosures. No sustainability reports look the same and content varies between companies. Our research finds that while most data is entered in supplementary tables, one third of all data comes from formats such as direct text entries and graphs.

This has implications for us, as it drives the need to use third-party data providers, who play a role in plugging the accessibility gap, while at the same time it comes with the caveat that data points are based on estimates. The validity of this data is thus contingent on the estimation methodology, something that several data service providers have been reluctant to show. This means that while they can help solve the accessibility issues, they also help confound the intrinsic quality issue.

Reliability: Data that has high quality assurance

Ultimately, for data to be usable in an investment context it needs to be reliable. Our investment decisions needs to be firmly anchored in a conviction that the reported sustainability numbers actually reflect what is going on in a company.

Our research shows that few companies use third-party assurance as a means to provide investors with signals of credibility. Looking outside of the Nordic region, this is certainly the case. Only 3% of U.S. companies had full assurance of sustainability reports and 36% had partial assurance, as reported by Si2 and IRRC Institute*. Applying the same lens to a Nordic context, it is evident that companies go further in terms of providing transparency through assurance: 31% of Nordic companies offered full-assurance of their sustainability reports and 34% had partial assurance.

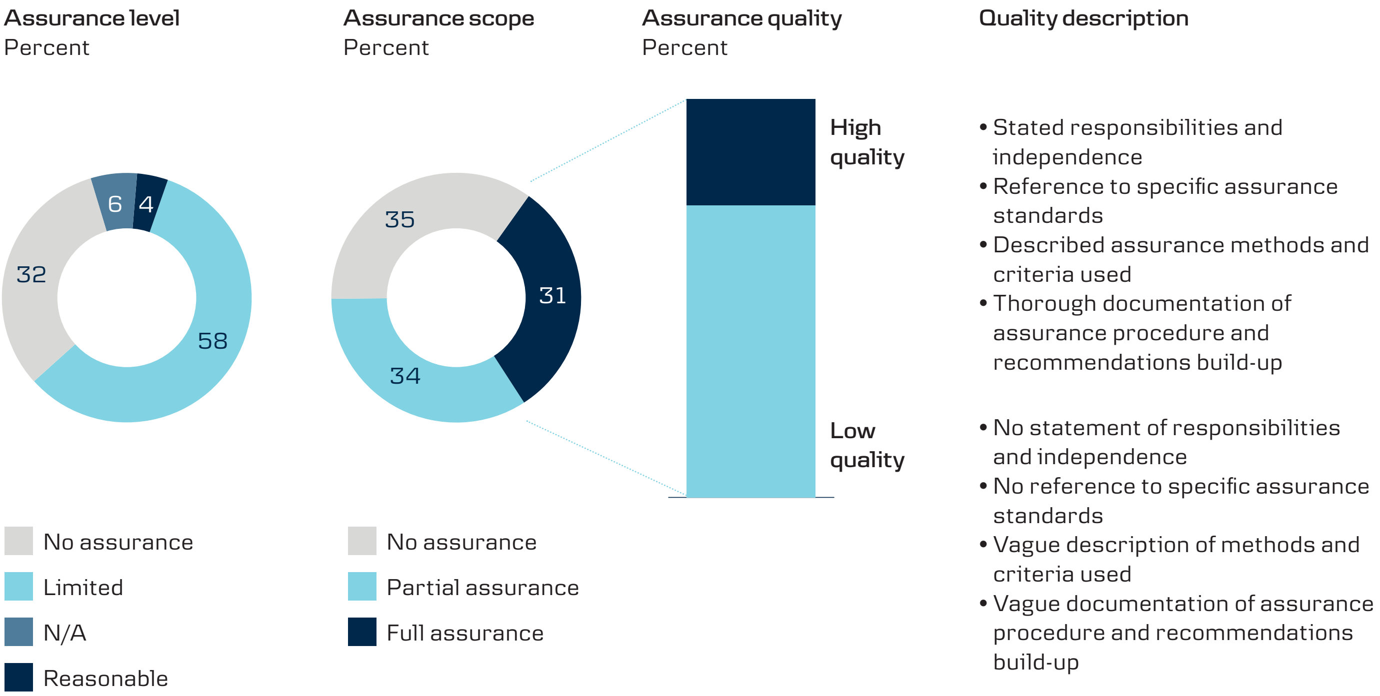
While this represents important steps in the right direction, we encourage companies to evaluate the use of third-party assurance further. According to the Si2 and IRRC Institute research framework* , only 4% of assured reports have a “reasonable” level of assurance while 58% have a “limited” level. Moreover, out of the 31 companies that offer “full assurance”, 23 companies lacked quality of the assurance statement, e.g., no statement of competency and responsibility of the assuror and no references to assurance standards. They were also often vague on description of methods used and offered only partial documentation of assurance procedures and the basis for recommendations.

While the question of how, and whether, companies make use of third-party assurance is relevant, it only scratches the surface of the real issue. For companies’ sustainability disclosures to carry weight they need to be anchored in sound governance and management and performance measurement systems. To that end, assurance standards play a significant part in helping us gain insights. Companies with high quality assurance will often use assurance standards geared specifically at sustainability disclosures and their underlying processes and management systems**.

** Si2 and IRRC Institute: State of Sustainability and Integrated Reporting 2018. ** Assurance based both on a combination of AA1000 and ISAE 3000 are likely to deliver enhanced results and are technically complementary*

Exhibit 6

Company use of 3rd party assurance: Split by assurance level, scope and quality



Concluding remarks

The need for and the positive impact of quality ESG data and sustainability disclosures is clear for us as an investor: it will help us understand better and give a more complete picture of the companies we invest in, and thereby help us making better-informed investment decisions.

Our ambition to contribute to and support companies' in their journeys to embed sustainability into their business and to report on financially material matters, is executed through our sustainable investment strategy ESG Inside, which focuses on ESG integration and active ownership through dialogue and engagement.

We are committed to building robust investment processes and take ownership of our ESG assessments, focus on materiality, i.e., what is business-critical, engage with portfolio companies to address the data challenge, and encourage the furthering of standardized and auditable reporting.

To this extent, we have developed our proprietary materiality dashboard called mDASH®, for our investment teams to assess and evaluate companies' sustainability performance and standards in a holistic manner.

- mDASH® is based on the SASB Materiality-map, which guides our understanding of – on industry level – which ESG factors may financially impact the companies we invest in.

- mDASH® makes available a large set of externally sourced data points from companies and third-party data providers, structured and categorized to help cut through the information noise by identifying financially material ESG topics which companies can be assessed against.

- mDASH® collates company dialogue data, which calibrates our evaluation and highlights progress and outstanding material issues for us to address with the companies we invest in.

We see great value in companies, investors, regulators and other key stakeholders working together to strengthen the quality of ESG data that is financially material, comparable, accessible and reliable. This will improve understanding of companies' development, performance and impact, and thereby contribute to authentic ESG integration in investment processes and the reorientation of capital flows towards more sustainable investments.