

# ESG

## Riding the Regulatory Wave



Exploring ESG Regulation Implementation Challenges



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## A new brand of Regulation

Whilst the world is still recovering from the effects of COVID-19, and adapting to the issues uncovered as a result of the Black Lives Matter movement, adopting sustainable practices and timely adherence to ESG regulations is pivotal in safeguarding a company's long-term success.



Widely recognised as being 'more than a fad or a feel-good exercise', it is clear that creating stronger ESG alignment [correlates with higher equity returns](#). Compliance with ESG regulations will create monumental changes to the financial services industry and it will take well-rounded experience in regulatory transition to ensure seamless adherence and minimal disruption to operations.



 Why now?

2020 will be remembered as the year in which environmental, social and governance (ESG) factors solidified their position as a dominant and permanent feature across the financial services landscape.

ESG is a thematic wave washing over everything in its path, akin to Digital Transformation and Diversity & Inclusion in the previous decade.

Russell Reynolds Associates  
ESG 2020: The Transformation of Financial Services  
March 2020



## A new brand of Regulation

Similar to the Know Your Client (KYC) and Anti Financial Crime (AFC) regulation landscape of five years ago, ESG regulation implementation will require heavy lifting from the advisory and consulting sectors. Compounded with this, firms need a commitment to transition and adjust investment principles and processes in order to achieve these ambitious goals.

This influx of new rules reflects the regulators attempts to catch up with longstanding [investor demand](#). As a result of these optional and mandatory principles, businesses are understanding the importance of having well-governed and socially-responsible practices in place, making it the optimal time for financial institutions to start planning for ESG rules implementation.



## Upcoming EU ESG Regulations

In the last three years, ESG regulations grew by 158% in the UK, and by [145% in the US and Canada](#).<sup>3</sup> The most regulated topics are business ethics and climate change in financial services, energy use and consumer rights in the US utilities, and product and service safety in healthcare and pharmaceuticals.

### ESG REGULATIONS for Asset Managers and Financial Institutions



**MiFID II Amendments** (in force Q1 2020) Advisers will need to be more proactive with customers in relation to ESG considerations by asking them about their preferences



**Stress Testing Rules for Banks** Tools and mechanisms to integrate ESG factors into the EU prudential framework, banks' business strategies, investment policies and risk management processes



**Benchmarks Regulation** Has been amended to include two new benchmarks to help increase transparency and avoid greenwashing



**The Taxonomy Regulation** (in force July 2020) Sets out a common classification system to determine which economic activities and investments can be treated as "environmentally sustainable"



**ENVIRONMENTAL**

Issues relating to the quality and functioning of the natural environment and natural systems e.g. carbon emissions, environmental regulations, water stress and waste

**SOCIAL**

Issues relating to the rights, well-being and interests of people and communities, e.g. labour management, health and safety and product safety

**GOVERNANCE**

Issues relating to the management and oversight of companies and other investee entities e.g. board, ownership and pay

**Upcoming EU Regulations**

These regulations will affect many areas significant to asset managers, from corporate governance to process and product considerations. Implementing these changes effectively in order to gain a competitive advantage over their peers and avoiding the burden of non-compliance will mean drawing up consistent definitions, identifying the data points needed to set comparable targets, monitoring investments and reporting to regulators. Additionally, they will have to consider their role in the design, delivery and sale of financial services and products.



## Data, Benchmarking and Disclosure

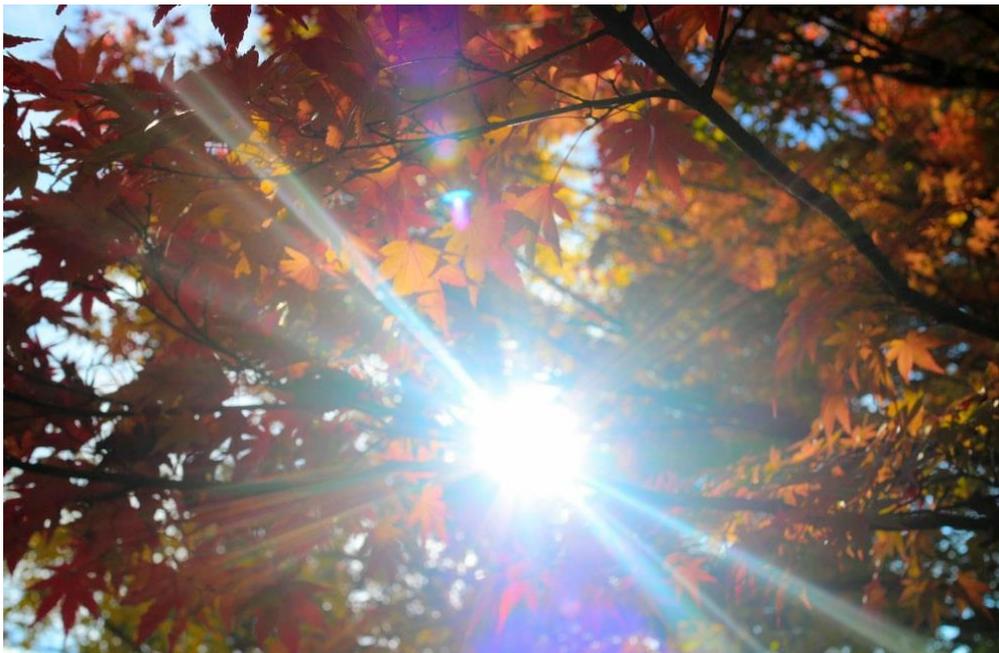
When it comes to benchmarking and disclosing data it is important to highlight the difference between 'sustainability' and 'ESG'. Specifically with ESG information, the devil is in the detail. Asset managers must perform this in-depth data collection to satisfy their own corporate reporting requirements, to conduct appropriate investment and risk management decisions, and to make disclosures to clients and fund investors.

Because asset managers produce, distribute and ingest financial and non-financial ESG data, these regulations can bring competitive advantage and clarity to those who implement them effectively.

A typical asset manager will have to ingest endless subsets of relevant ESG considerations from various asset classes, industries and geographies all of which depend on differing underlying data in order to reach informed and accurate decisions. The major challenge is being able to determine the data points required to set comparable targets, monitor investments, and measure and compare performance across sectors, industries, and national or regional borders.

## Implementation Insights

A proactive approach is essential as it enables firms to gain an early understanding of the changes needed to their operations and position them as credible, trusted partners with regulators.



Once an organisation has established its guiding vision and strategy for implementing investment principles, the real work begins. Updates to compliance, risk management, product development, data management, sales and reporting processes all need to take place and have to be coordinated across business units and functions to ensure consistency and traceability.

## Implementation Insights

Analysis and assembly of regulations, standards and good practices, clear and up-to-date management views and evaluation of peer approaches all have to be part of a holistic regulatory implementation approach.



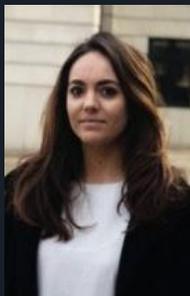
### [2019 – 2021 implementation timeline](#)

Whilst trying to predict the future and see the outcomes of implementing these future-facing requirements, it is important to remember the importance of flexibility and adaptability. The transition has to be well-managed and sustainable to be maintained. It is also important to incorporate lessons learnt from previous regulatory implementations. The organisations who will come out the strongest will be those who take the time to invest and begin with a good understanding of the changes in the operational environment and internal capabilities required.

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Environmental Social & Governance (ESG) and Sustainable Investment

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Rajen Madan

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Responsible for delivering digital FS businesses.

Change leader with over 20 years' experience in helping financial markets with their toughest business challenges

This is the third in a series of blogs that will explore the ESG world: its growth, its potential opportunities and the constraints that are holding it back. We explore the increasing importance of ESG and how it affects business leaders, investors, asset managers, regulatory actors and more.



### **Artificial Intelligence: the Solution to the ESG Data Gap?**

In the second part of our Environmental, Social and Governance (ESG) blog series, Anya explores the potential opportunities surrounding Artificial Intelligence and responsible investing.



### **Is it time for VCs to take ESG seriously?**

In the fourth part of our Environmental, Social and Governance (ESG) blog series, Ben explores the current research on why start-ups should start implementing and communicating ESG policies at the core of their business.



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