

ESG as a key pillar of investment strategy

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Eigil Ingebretsen is Head of Investment Control & Analytics in Storebrand Asset Management AS (SAM) — a Nordic multi-boutique asset manager offering a wide range of products within traditional and alternative asset classes. Within his role, Eigil is responsible for several areas, such as the valuation of financial instruments, performance, risk and environmental, social and governance (ESG) analytics and reporting, investment compliance on all products and portfolios and data governance and contracts. Managing areas and analysts that are data and model owners requires a keen understanding of data governance and management processes, and Eigil offers a wide range of perspectives in balancing both business and technical aspects in a strategic, tactical and operational context. His legal background and experience are also helpful in navigating a regulatory environment that has undergone significant changes.

ABSTRACT

In this paper we delve into the importance of environmental, social and governance (ESG) considerations as a cornerstone in investment strategies. The discourse takes the reader through a transformative journey, from understanding key pillars that needs to be addressed to truly succeed in ESG integration from setting the level of strategic ambition to it effectively into investment processes, focusing particularly on process integration and management. We explore key process steps in an investment process, such as strategic allocation, security selection, portfolio construction with a particular emphasis on risk assessment, stress testing and investment compliance. Specific examples are provided to elucidate how ESG considerations can be seamlessly incorporated into these critical steps to achieve fully aligned portfolios. Upon completion of the paper, readers can

expect to gain a robust understanding of the ESG landscape, insights on how to integrate ESG considerations into their investment decisions and tools to future-proof their portfolios. The knowledge and skills acquired will be invaluable for asset managers, investors and other finance professionals looking to align their strategies with the emerging realities of the current investment landscape.

Keywords: ESG, data, data models, process integration, investment strategy



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INTRODUCTION

The finance industry has undergone a dramatic change during the last few years and is still in a transitional phase — a lot due to regulation, but also due to increased attention and scrutiny from the client side. More than ever before, environmental, social and governance (ESG) factors must be fully integrated into investment strategies, driven by an increase in investor demand, regulatory requirements and the growing recognition of ESG risks and opportunities. What once was considered a peripheral, ‘nice-to-have’ approach has now established itself as a core pillar of sound investment strategy.

The industry has experienced a growth in assets under management (AuM), and it is imperative to note that the growth in assets is not isolated from ESG considerations. In fact, ESG is increasingly becoming a fundamental factor driving this growth. Globally, asset managers are projected to increase their ESG-related assets under management to an impressive US\$33.9tr by 2026, up from US\$18.4tr in 2021.¹ Bloomberg Intelligence even suggests allocated investments upwards of a staggering US\$50tr by 2025. Substantial

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growth in ESG-related AuM underlines the rising demand for ESG investment products and the growing importance of ESG integration in asset management.

Integrating ESG into investment strategy is more than just an avenue for capturing a share of the growing ESG market. It is about proactively managing ESG risks and harnessing opportunities. ESG integration enables asset managers to gain a more comprehensive understanding of the companies they invest in, assessing not just their financial performance and potential but also their environmental stewardship, social responsibility and governance quality.

Further, ESG integration can enhance investment performance, providing a more resilient and diversified portfolio. ESG factors, often overlooked in traditional financial analysis, can offer unique insights into a company's long-term prospects. A company with strong ESG performance is likely to be more innovative and explorative of new technology, more resilient to environmental and social shocks and less prone to corporate scandals, thus contributing positively by being included in an investment portfolio.

Successful integration of ESG is also about avoiding negative consequences and attention. Regulators around the world, particularly in Europe, are ramping up their requirements for ESG disclosure and integration. Asset managers who fail to take ESG into account may face regulatory penalties, reputational damage and loss of investor trust.

When using the term 'ESG factors', it refers to data points that somehow are related to ESG. These could be quantitative and qualitative, but for investment strategy it is the former that is most relevant. A lot of focus is now on factors related to regulation, such as but not limited to principle adverse impact indicators (PAI) in the SFDR regulation.² There are several PAI that indicates ESG risks related to environmental, social and governance. An example

of environmental risk is the greenhouse gas (GHG) emissions in scope 1–3. We explore pillars of importance that are factor agnostic.

It is easy to get caught up in specifics such as data points, data flow, process integration and system usage, but it is important to keep in mind that the finance industry is uniquely positioned to have a positive impact on the biggest global challenge of our times. This should never be forgotten in questions of *what* and *how*. The *why* must always be the centre of attention. We are going to dive deeper into the pillars of an ESG framework that should be addressed to truly succeed in the integration of ESG in line with a company's long-term ambitions, regulations and client expectations:

- (1) Establishing the company ambition;
- (2) Setting proper governance framework;
- (3) Building an ESG-centric culture and literacy;
- (4) Building a holistic data model;
- (5) Integrating ESG into portfolio management processes;
- (6) Enhancing ESG transparency through effective reporting;
- (7) Implementing robust internal control and auditing procedures.

ESTABLISHING THE COMPANY AMBITION

Establishing the company ambition is a critical first step in embedding ESG into the core of an investment strategy. At its heart, this ambition should reflect the company's commitment to sustainability, providing a strategic vision that goes beyond mere compliance and drives towards actively shaping a more sustainable and resilient financial future.

In essence, the company's ambition should be a bold, yet tangible declaration of its sustainability intent. In McKinsey's 2022 report, 'How to make ESG real', the

consulting company argues that a ‘next level’ practice is to fully incorporate ESG into the company’s strategy.³ This ambitious step goes beyond just integrating ESG considerations into investment decisions. It means making ESG central to the organisation’s very identity, business model and value proposition. It suggests a future where sustainability is not just one of the many strategic considerations, but a defining element of the company’s strategic agenda.

This ambition must be articulated clearly and convincingly, translating into actionable, measurable goals. These goals should be aligned with globally accepted sustainability targets such as the United Nations’ (UN) Sustainable Development Goals (SDG). They should also be customised to the company’s unique context, considering its specific ESG risks and opportunities, operational capabilities and stakeholder expectations.

Establishing the company’s ambition is not a mere box-checking exercise, but a powerful strategic tool. It sets a clear ESG trajectory for the company, providing a roadmap for all stakeholders, from the board and management to employees and investors. It also sends a strong signal to the market, demonstrating the company’s commitment to sustainability and positioning it among competitors in the ESG space. The ambition should commit the company in all internal processes, strategic, tactical and operational, such as the development of operating models, product development processes and project and development roadmaps.

Furthermore, the company’s ESG ambition can inspire and motivate the workforce. It offers employees a sense of purpose beyond the profit motive, instilling a shared commitment to achieving sustainability goals. It also promotes a culture of sustainability within the organisation, fostering behaviours that align with ESG principles. Successfully involving the workforce in this work could

be a tool for creating a value-driven culture that could offer benefits well beyond the area of ESG integration.

In addition to not being a box-checking exercise, establishing the company ambition should be a dynamic process. As ESG challenges and opportunities evolve, so too must the company’s ambition. It requires constant reassessment and readjustment, demanding agility and foresight from the company’s leadership. It should be an inclusive process, involving all stakeholders in shaping the company’s ESG ambition. This participatory approach not only ensures the ambition’s relevance and acceptability but also strengthens stakeholder buy-in, boosting its chances of successful implementation.

SETTING PROPER GOVERNANCE FRAMEWORK

Institutionalising ESG requires a comprehensive governance framework that delineates roles, responsibilities and accountability mechanisms. This framework not only guides ESG decision-making processes but also ensures the alignment of ESG objectives with the overall business strategy.

The design of an effective ESG governance framework depends on the company’s ESG ambition, as discussed above. The level of ESG integration envisaged by the company would dictate whether it should concentrate ESG expertise within specialised teams or spread across the entire organisation. For instance, a company that seeks to fully embed ESG into its business strategy may choose to build ESG competence throughout the organisation, promoting ESG literacy among all staff and integrating ESG considerations into all business functions and processes. Conversely, a company that aims to excel in specific ESG areas may opt to maintain specialised ESG teams that possess deep expertise in these areas and can drive targeted ESG initiatives.

Setting the tone from the top is important and it starts with the board of directors, who bear the ultimate responsibility for overseeing the strategy. They ensure alignment with the company's strategic direction and monitor its implementation progress. This role demands a sound understanding of ESG issues and their implications for the company's strategic performance and risk profile.

The chief executive officer (CEO) is the organisation's primary ESG advocate and ambassador. Their role extends beyond merely endorsing the ESG strategy to actively driving its execution. They should infuse ESG considerations into the company's culture, operations and communication, fostering an organisational environment conducive to ESG integration. The CEO must be ready to front the company's strategy for a wide variety of stakeholders, including potential controversies considering ESG.

The chief investment officer (CIO) is key in succeeding with the ESG ambition set in the company. Making sure to include ESG considerations in portfolio management processes is vital to make sure that all decision processes are well-defined and fit for purpose. To make sure that ESG is considered in portfolio management processes, the CIO should be as much an advocate for ESG as the CEO; however, the role must balance the pressure to deliver on the financial ambitions of the investment strategies against ESG considerations that may not materialise for several years.

The chief operating officer (COO), the chief data officer (CDO) or the chief technology officer (CTO) are likely to be the owner of the technology and data platforms. These roles are key to making data available and making it useful for the business side, including portfolio managers. Ensuring that these roles facilitate the business needs both now and in the future is vital.

The chief risk officer (CRO) is tasked with identifying, assessing and mitigating ESG risks, thus safeguarding the company's

financial health and reputation. To fulfil this role effectively, the CRO should be well-versed in ESG risk methodologies and tools and possess a strategic mindset to anticipate and manage emerging ESG risks.

Finally, as we see sustainability linked to financial reporting and results, the chief financial officer (CFO) plays a pivotal role in intertwining ESG considerations with financial planning, performance measurement and risk management. They must ensure that the company's financial strategy and decisions adequately reflect ESG risks and opportunities, thereby contributing to a more resilient and sustainable financial performance.

Now, an asset manager may also benefit from establishing a role in senior management with the responsibility to focus on all strategic and tactical aspects of ESG. Having a chief ESG officer or a chief sustainability officer (CSO) could be the role that is the main sponsor of all activities related to this internally and binds everything together. The value of this role depends on the complexity of the organisation and business, and the need to appoint a role that could be the figurehead for all ESG-related matters.

Beyond the traditional C-suite roles and more on the operational side, the successful integration of ESG into the organisation requires some additional, distinct roles. Among these, the roles of 'data owner' and 'calculation owner' are integral. The data owner is tasked with ensuring the quality, integrity and availability of ESG data, which is vital for informed decision making and credible reporting. The calculation owner is responsible for ensuring the accuracy and consistency of ESG-related calculations, playing a pivotal role in the integrity of ESG assessments and reporting.

Product owners and report owners also have crucial roles to play in this ESG journey. Product owners must ensure that their products align with the ESG ambition, integrating ESG considerations into product

design, development and management. Reporting owners, on the other hand, must make sure that ESG reporting is accurate, comprehensive and consistent, contributing to transparent and credible ESG disclosures. In specialised roles such as ESG portfolio managers and ESG analysts, the individuals are key to embedding ESG considerations into investment decision-making processes.

Setting up a proper governance framework is a complex yet necessary process for successful ESG integration. It calls for strategic planning, clear role definition, and effective accountability mechanisms. It necessitates alignment with the company's ESG ambition, ensuring that the governance structure supports and accelerates the fulfilment of its ESG objectives. A good practical start could be to document the roles and responsibilities in a responsible, accountable, consulted and informed (RACI) matrix.

BUILDING AN ESG-CENTRIC CULTURE AND LITERACY

An essential cornerstone of executing an ESG-based strategy is fostering an ESG-focused organisational culture and boosting ESG literacy throughout the entire workforce. Such an endeavour reaches beyond the confines of merely imparting knowledge

of ESG concepts. It encompasses embedding an understanding of the importance of these concepts and instilling a sense of responsibility towards achieving sustainability goals across all tiers of the organisation. The goal is to dissolve departmental silos and integrate ESG principles into day-to-day operations and decision-making processes.

Implementing a deeply ingrained, ESG-centric organisational culture necessitates a comprehensive and dynamic approach. A foundation of robust education is essential, encompassing extensive training programmes, interactive workshops and seminars to enhance ESG literacy. This effort involves fostering a workforce that is not only educated about current ESG principles but also stays abreast of evolving trends and developments within the ESG landscape.

To achieve this, organisations can explore continuous learning programmes that keep employees informed and engaged with the ever-shifting nuances of ESG considerations. Encouraging participation in relevant professional certifications and providing access to a plethora of ESG-centric resources, such as newsletters, journals and webinars, can further enhance knowledge and commitment.

It is important to understand, however, that creating an ESG-centric culture is more

Table 1: Example on a RACI matrix based on key activities and responsible entities or roles

| Step | Activity | BoD | CEO | CIO | CSO | COO | CPO |
|------|--|-----|-----|-----|-----|-----|-----|
| 1 | Establishing ESG strategy | A | A/R | C | C | C | I |
| 2 | Adoption in internal guidelines | I | A | C | R | C | C |
| 3 | Adoption in product creation process (investment strategy) | I | A | C | C | I | R |
| 4 | Establishing data model and architecture | I | I | C | C | R | I |
| 5 | Integration into investment process | I | I | A/R | C | I | I |
| 6 | Reporting and information distribution | I | I | C | R | R | A |

R = responsible; A = accountable; C = consulted; I = informed

than a matter of expanding knowledge; it requires a systemic embedding of ESG values into the organisation's very ethos. Organisations should aim to cultivate an environment that encourages and rewards behaviours reflecting ESG principles. This could take the form of promoting cross-departmental collaboration on sustainability projects, recognising and rewarding innovative solutions to ESG-related challenges or celebrating employees who make noteworthy contributions to sustainability objectives.

Establishing a company-wide responsibility for ESG goals and strategies can create a culture where ESG considerations become an integral part of the corporate identity. This fosters a proactive and engaged workforce that understands and values the impact of their decisions on the company's ESG goals.

The fostering of ESG literacy can also extend beyond the organisation's boundaries. By promoting ESG literacy among its stakeholders, the organisation can drive wider changes in the industry and contribute to the larger sustainability agenda.

Now, succeeding with a culture of ESG literacy is a long-term project. Triggering excitement and curiosity is a vital part of it, but so is setting clear expectations. Companies should try to find a balance between motivation and expectation. Hiring policies and processes may also be helpful tools to identify candidates with a professional drive that is aligned with the company's ambitions.

In summary, instilling a culture of ESG literacy and responsibility across the entire organisation is a complex but vital undertaking. This endeavour is fundamental in achieving the organisation's ESG ambitions and aligning its operations and strategy with sustainability principles. By doing so, companies can position themselves at the forefront of the ESG landscape, ready to adapt, grow and succeed in the ever-evolving sustainability-focused business environment.

BUILDING A HOLISTIC DATA MODEL

Constructing a robust, comprehensive data model is a cornerstone of effective ESG integration in asset management. This process calls for an intricate blend of diverse ESG data into an efficient structure for systematic data collection, processing, interpretation and investment decision-making application.

Aligning with insights from McKinsey's 2023 report, 'ESG data governance: A growing imperative for banks', significant transformations to the existing IT infrastructure become essential to this undertaking. It necessitates adjustments extending beyond applications to the more profound layers of data integration, architecture, and most critically, data governance. Most importantly, it links the need to create an efficient data model with the need for process integration.⁴

ESG data governance assumes a pivotal role in achieving reliable and effective integration. It provides a framework to ensure data accuracy, consistency and availability, directly affecting the quality of ESG assessments and decision making. Considerations must be made in the design of the data model, such as ambitions, present and future requirements for insights, asset classes to cover and overall system architecture. This process should not be taken lightly, as missteps may lead to difficulties in realising the company's ambitions and client and market expectations.

The key role that data owners take on is crucial in this sense, making sure the model design is fit for purpose and future-proof. Data owners must uphold the integrity and quality of ESG data, ensuring its appropriateness for strategic application. They serve as the guardians of data quality, confirming the data's relevance, timeliness, completeness and compliance with applicable standards. Involving this role in architectural and strategic processes related to infrastructure, applications and data models is important.

Moreover, data owners play a key role in setting expectations for data vendors. Vendor due diligence becomes essential given the

reliance on external data sources for comprehensive ESG information. It involves evaluating vendors' data collection, processing and quality assurance practices, ensuring alignment with the company's ESG standards and requirements. Data owners must also make certain that the terms of data usage are regulated in contracts, ensuring data protection and compliance with data privacy regulations.

Creating a comprehensive ESG data model also requires a rigorous methodology for assessing ESG performance and a robust quality assurance process. It is essential to consider the multifaceted nature of ESG data, which is not only quantitative but also qualitative, forward-looking as well as historical, specific to both companies and industries, and contains financial as well as non-financial information.

Recognising this complexity, a methodical approach to data management is vital. It involves categorising, storing and maintaining data in a structured and organised

manner, facilitating easy access and usability. This becomes especially important in the face of burgeoning ESG data volumes.

While advanced technology solutions can augment data management, the importance of human oversight and expertise in understanding, interpreting and applying ESG data in its right context cannot be overstated. This necessitates continuous training and education for staff, particularly those involved in investment decision making. Having robust controls in place to identify outliers, gaps or other data incidents is important. Involving resources who know the company and the specific data points could be equally important.

Constructing a holistic ESG data model is a complex but critical endeavour for successful ESG integration. It is underpinned by solid data governance, clear data ownership, diligent vendor management, and importantly, the skilful blending of technological and human efforts (see Figure 1).

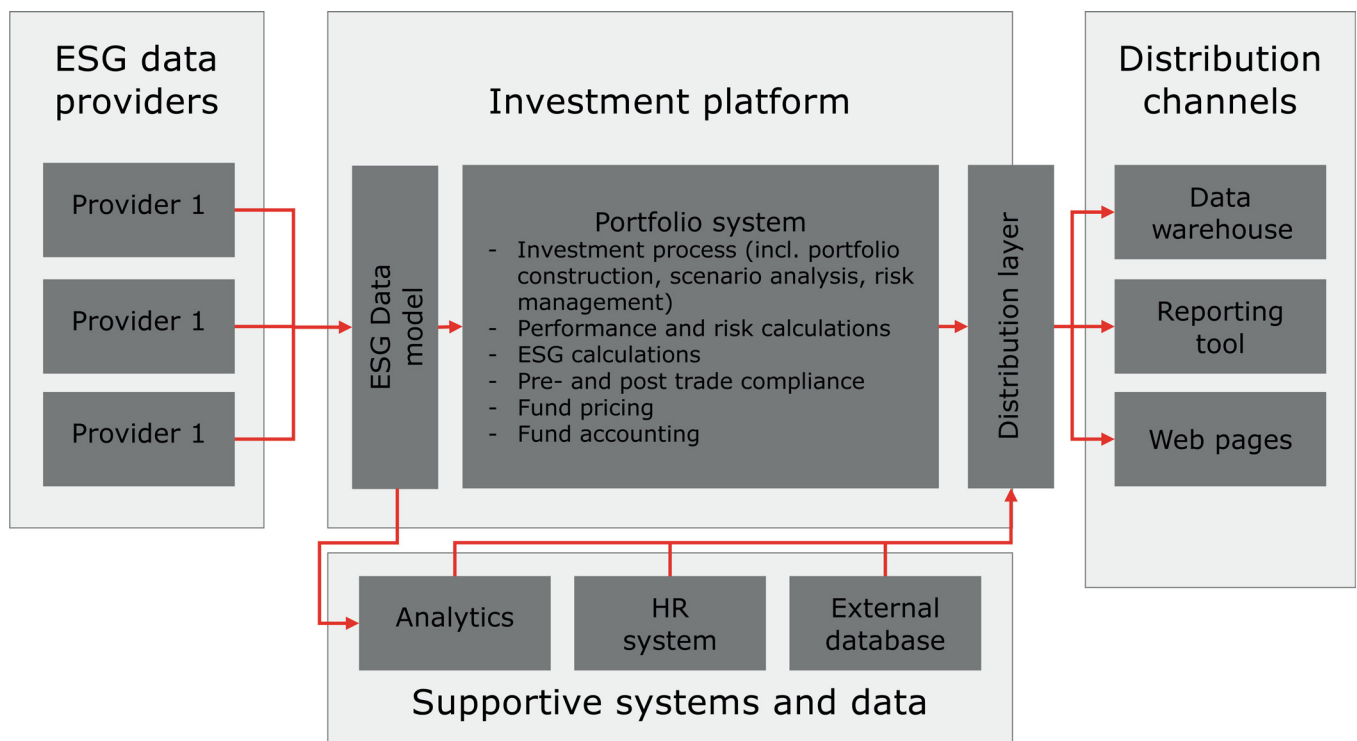


Figure 1 Example of data architecture

INTEGRATING ESG INTO PORTFOLIO MANAGEMENT PROCESSES

The heart of any asset management company is its portfolio management capabilities. The incorporation of ESG considerations into portfolio management processes thus emerges as a cornerstone in actualising a comprehensive ESG-centric investment strategy. This involves infusing ESG data into every facet of portfolio management processes, from allocation, selection and portfolio construction to portfolio monitoring, rebalancing, risk assessment, stress testing and compliance.

The recent CFA Institute survey underscores the growing importance of ESG considerations in portfolio management. It reports that asset managers' expectations for ESG portfolio percentages over the next 12 months have surged by over 13 per cent compared to last year. Asset managers anticipate that nearly two-thirds of their portfolios will incorporate ESG elements within the next decade. The heightened effectiveness of ESG tracking tools, metrics and services is reflected in the responses, with over 90 per cent of respondents acknowledging their efficacy, a substantial increase from 66 per cent in 2021.⁵

ESG integration across all asset classes has increased year-on-year, with the most significant expansion noted in fixed income. Incorporation of ESG factors in fixed income allocations has experienced a dramatic rise to 76 per cent in 2023, up from 42 per cent just a year prior. Moreover, the trajectory for this trend is clear, with over 80 per cent of global asset managers anticipating increased utilisation of ESG criteria across all major asset classes in the next 12 months.⁶

Given these trends, the initial step for integrating ESG considerations in portfolio management processes is the development of robust ESG risk-assessment frameworks. Such frameworks aim to identify, quantify and monitor ESG risks associated with each asset within a portfolio. To achieve this, asset

managers must effectively leverage their ESG data model and organisational literacy. How an investment team or a portfolio manager chooses to design the portfolio management process may vary significantly based on other factors asset class, type of style and strategy, number of products and clients or generally on the available investment universe.

Figure 2 shows how an investment team or a portfolio manager may incorporate ESG into these general portfolio management steps.

- (a) Strategic allocation;
- (b) Security selection;
- (c) Portfolio construction;
- (d) Portfolio monitoring and rebalancing;
- (e) Risk assessment and stress testing;
- (f) Investment compliance.

Strategic allocation

Strategic allocation involves determining the investment direction, with decisions on how much to invest in different industries, sectors or countries. When integrating ESG considerations, portfolio managers need to extend beyond traditional risk management, aligning investment strategies with positive ESG outcomes. They must assess the ESG profile of different sectors, industries and countries, factoring these into their strategic decisions. For instance, given the increasing awareness and impact of climate change, a portfolio manager might decide to allocate a higher proportion of assets towards green energy or sustainable agriculture — sectors that promise both strong returns and positive environmental impact. How ESG is considered in the strategic allocation depends on the investment strategy.

Security selection

The next stage is the selection of individual securities within the strategic allocation. This is a process that requires comprehensive research and due diligence. When considering ESG factors, companies and

securities are analysed not just for their financial potential but also for their ESG impact. This could involve using scenario analysis and stress testing to understand the potential impact of various ESG factors on the company and security performance under different scenarios. For instance, a portfolio manager might opt to invest in a manufacturing company that has robust policies and practices for minimising its environmental footprint and ensuring good labour conditions, over another company with similar financial performance but weak ESG practices.

Portfolio construction

After selecting the securities, the next stage involves constructing the portfolio. ESG integration at this stage means that the weightage and combination of securities reflect the portfolio's ESG objectives. For instance, in constructing a portfolio with an ESG focus, a manager might opt for a higher weightage of companies with strong ESG ratings, thereby contributing to the portfolio's overall ESG score. In this step, however, overall risk management considerations are vital. Having significant exposure to a small set of companies, sectors or industries may be unfortunate. It all depends on the strategy that is set and what the investors may expect from the portfolio capabilities.

Portfolio monitoring and rebalancing

Portfolio managers need to continuously monitor the portfolio's performance against its set ESG objectives. This involves tracking changes in the ESG performance of individual securities and the overall portfolio. If the actual allocation deviates from the strategic allocation due to varying returns from different assets, rebalancing becomes necessary. For example, if a company in the portfolio has a significant ESG controversy or significantly outperforms, the portfolio manager might decide to reduce or increase its exposure in the rebalancing process.

Risk assessment and stress testing

ESG integration should be an integrated part of the regular risk assessment, monitoring and stress testing processes. This involves identifying, quantifying and monitoring ESG risks and testing the portfolio's resilience to various ESG-related or non-ESG-related scenarios. For example, a stress test might involve assessing how the portfolio would perform under severe climate change scenarios or regulatory changes aimed at curbing carbon emissions.

Investment compliance

Finally, integrating ESG considerations requires ensuring that all investments comply with the company's ESG policies and guidelines. These policies and guidelines should be included either as restrictions or as guidelines. It would benefit the overall portfolio management process to have a pre-trade compliance check included. This could avoid potential breaches of policies and guidelines that could potentially cause a loss of reputation for the asset manager, depending on the severity of the breach. For instance, if a company has a policy against investing in companies involved in controversial weapons, the portfolio manager needs to ensure that none of the proposed trades involve such companies.

In conclusion, the integration of ESG considerations into portfolio management processes represents a foundational shift in how asset management firms operate. This transformative process involves embedding ESG data across all stages of portfolio management, fostering portfolios that align with ESG ambitions, yield solid financial returns, and contribute towards a sustainable financial system. The focus is as much on identifying opportunities as it is on avoiding risks. Success in this arena should be gauged not solely by financial performance but also by the contribution towards a sustainable future.



Figure 2 Example of a portfolio management process

ENHANCING ESG TRANSPARENCY THROUGH EFFECTIVE REPORTING

The role of reporting in ESG integration is multifaceted, serving internal decision-making needs and external communication

purposes. Effective reporting practices not only validate the company's commitment to ESG principles to external stakeholders but are also widely used internally. This internal role is fulfilled by monitoring progress

towards ESG objectives and by identifying areas requiring action plans.

A well-structured reporting strategy necessitates regular internal reporting of ESG performance indicators. This facilitates informed decision making by delivering crucial insights to steer the ESG strategy. Internal reports should encompass various dimensions, such as portfolio-level ESG performance, impact evaluations and progress updates on ESG-related initiatives.

This information feeds into the strategic direction, highlighting areas of success and those in need of attention. Such visibility helps to ensure alignment of operations and strategy with ESG goals and informs risk management, new product development and overall business strategy.

For instance, a company report might detail the implementation of an ESG strategy, its impact on the company's operations and financial performance, and how the company is innovating to drive ESG performance. Company reporting should also highlight how ESG risks and opportunities are managed at the executive and board levels.

In parallel, product reporting is crucial to illustrate how individual products or funds align with ESG criteria, such as adherence to the European ESG Template (EET) standards for product reporting. This type of reporting could include data on the ESG ratings of the assets within a fund, the carbon footprint of a portfolio or the social impact of investments.

Externally, comprehensive and credible reporting displays the company's ESG commitment and performance to clients, investors and other stakeholders. As ESG-focused investment becomes more mainstream, clients and investors increasingly require detailed and reliable information about a company's ESG performance and the ESG characteristics of the products they are investing in. In this regard, alignment with globally recognised sustainability reporting

standards is paramount to ensure credibility and comparability.

But effective reporting is not confined to merely presenting raw data. A key aspect is the narrative that threads the data together, painting a vivid picture of the company's sustainability journey, achievements, obstacles encountered and future ambitions. The storytelling element of ESG reporting is a powerful tool for engendering trust among stakeholders. It allows the company to present a cohesive narrative about its ESG journey, providing context to the data and highlighting the company's ongoing commitment to transparency and sustainability. External reporting should be a window into robust and integrated ESG processes, while keeping the material approachable on a level that speaks to the clients or other stakeholders.

A well-rounded reporting strategy should be seen as an integral component of ESG integration, providing valuable insights to both internal and external stakeholders. It enables the company to demonstrate its progress, tell its sustainability story and ultimately build trust with all stakeholders, including employees, clients, investors and society at large.

IMPLEMENTING ROBUST INTERNAL CONTROL AND AUDITING PROCEDURES

The establishment of stringent internal control and auditing procedures is an indispensable step towards successful ESG integration. These mechanisms serve as the cornerstone in assuring the accuracy and dependability of ESG data, as well as guaranteeing adherence to ESG policies. They constitute a pivotal review system designed to spot discrepancies, inconsistencies, or potential improprieties.

One of the best practices in setting up an internal control system is the application of the three lines of defence model.

This framework distinctly separates the functions of management control, risk and compliance oversight, and internal audit to ensure the efficiency and effectiveness of risk management:

- (a) *The first line of defence:* Operational management controls;
- (b) *The second line of defence:* Risk management and compliance;
- (c) *The third line of defence:* Internal audit.

First line of defence

The first line of defence consists of operational controls implemented by management. This line plays a pivotal role in the day-to-day management of ESG-related risks and includes controls to prevent misconduct and manage financial risks associated with ESG factors. For instance, portfolio management and operations departments could be responsible for ensuring compliance with environmental regulations and sustainability practices.

Second line of defence

The second line of defence includes oversight functions such as risk management and compliance, responsible for providing a framework, guidance and tools for risk management and ensuring that the first line operates within this framework. This could involve the compliance team overseeing the implementation of ESG policies and procedures, monitoring adherence and identifying areas for improvement.

Third line of defence

The third line of defence is the internal audit function, responsible for providing an independent and objective evaluation of the company's ESG practices. This entails assessing the effectiveness of both the first and second lines of defence and the overall functioning of the ESG risk management framework. Internal auditing procedures should scrutinise the alignment of ESG

practices with the company's ambitions, the efficacy of ESG controls, and the reliability and transparency of ESG reporting. Any discrepancies or areas for improvement that are identified should be promptly rectified to ensure continuous advancement of ESG performance.

Despite the emphasis on internal controls and auditing, the process does not stop at internal validation. External validation forms an integral part of the ESG integration strategy. This could be accomplished by seeking external ESG certifications, achieving favourable ESG ratings or undergoing ESG assurance by accredited professional service providers.

By incorporating robust control and auditing mechanisms, companies can not only assure stakeholders of their ESG performance but also create an opportunity for continual improvement, thereby reinforcing their commitment to sustainability and responsible business practices.

CONCLUDING REMARKS

ESG integration in investment strategies has shifted from being a secondary consideration to a crucial factor that drives long-term value. To effectively embed ESG principles into the corporate ethos, an asset manager should consider these seven steps:

- (1) Set an ambitious, actionable and comprehensive ESG vision that guides strategic decisions;
- (2) Establish robust governance frameworks and clear roles that align all stakeholders with the ESG strategy;
- (3) Build a data-centric model with sound data governance and due diligence protocols;
- (4) Cultivate an ESG-centric culture through training programmes, continuous learning and embedding ESG values;
- (5) Integrate ESG factors into portfolio

management processes with rigorous methodologies ensuring alignment with the company's ESG ambitions;

- (6) Implement transparent reporting to display a commitment to sustainability, facilitating internal data-driven decision making;
- (7) Set up internal control and auditing procedures to maintain ESG data accuracy and adherence to ESG policies.

In conclusion, ESG integration is a strategic imperative that enables sustainable value creation and builds a resilient, inclusive financial system. Embracing these steps allows asset managers to transform challenges into opportunities, making significant contributions towards a sustainable world.

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