INDEPENDENT EQUITY RESEARCH
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ESG DATA TRAP; USE GOVERNANCE INSTEAD

- **ESG data supply combined with an index/ETF push is conducive of greenwashing across the ESG value chain. So say regulators, albeit in more educated ways. We checked and agree (see Demo below).**
- **Without stricter definitions, green-washing investment decisions are bound to prosper and lead to accidents. This is likely to happen as only a handful of buy-side users of ESG data have the human analytical resources to make sense of it.**
- **ESG as a business is painfully long on algos and short on experienced human eyes.**

The French market watchdog, AMF, made public a well-structured and well-documented non-regulatory piece[1] on the provision of data and data analytics on all things ESG. It makes for a healthy reading about the concentration of such data in a limited number of hands, the untold conflicts of interest, the inconsistent results of various algos (already much researched by various universities) and the fact that data crunchers tend to be data scientists with little understanding of the real world out there. Sure enough, AMF jointly with Dutch AFM is now calling for regulation of the ESG data business. That is a measure of the ongoing ESG data mess.

[1] *Microsoft Word - 20201208 Fourniture de données ESG_Cartographie_VF_publication.docx (amf-france.org)

We agree with that review as it confirms that collecting ESG data and shaking it does not really begin to help investment decisions by fund managers. The vast majority does not have a robust investment process that will include ESG-type data in a consistent, transparent and opposable way, day and night. *Ergo*, there is an inherent risk in using third-party data that is inherently unstable in a stock selection process which is rarely a stable one anyway. In other words, ESG 'analytics' turn out to be a risk amplifier if they are not actively challenged, notably by investment managers with a duty to protect third-party money.

We only mention, *en passant,* the massive issue of herd-like investment choices when ESG-type data is made available to all by an oligopoly of suppliers and when it is a fact that equity (and corporate bond) prices are driven by whether this or that stock/bond will be onboarded in this or that ETF for its perceived ESG profile. When money is ETF-driven, it is wiser to join the crowds. The cost of such 'dumb' investment strategies will ultimately be borne by asset owners. Too bad if such strategies are not exactly compliant with what the ESG mandate implies for the fund managers themselves: apply proper governance, i.e. fiduciary responsibilities, at the fund management level itself. Investing in an ESG-driven ETF is unlikely to be the easy ride that it promises to be.

For the sake of the exercise about checking score-based ESG metrics, we matched the ESG scores (a senseless concept as the 3 letters are contradictions in terms) provided by Sustainanalytics, Refinitiv, MSCI, S&P -Robeco and ISS with the coverage universe of AlphaValue. AlphaValue is traditional equity research with its very own ESG metrics built up over the last 10 years. It always rejected the principle of a combined E+S+G scoring and has its Sustainability score built from its own, proprietary, and independent data. Each single word here has its importance. As does the fact that this data comes from its own financial analysts – aka human beings with industry knowledge and able to read a full company report - who know a thing or two about the gap between corporate blurb and reality.

AlphaValue metrics are obviously as fragile as the 'garbage in' that characterises ESG non-financial data. But AlphaValue has for it to be absolutely independent on an *investor-pays* model to have been building up its own ESG data sets over the last 12 years and to be rather versed in detecting who is pushing the envelope. The confidence in our data and procedures is such that sustainability metrics are impacting valuation ones in real time. That is a statement *per se.*

It stands at the opposite end of ESG data-based investment decisions where stock-picking talent has evaporated.

Demo

While AlphaValue manages to score 460 stocks, essentially big European caps, we could find only 344 with matches at ESG data providers. *Ergo*, data providers still have big holes in their rackets. We concentrated on the 62 names that garner poor scores at AlphaValue (see table below for an overview) as this is where there is fodder for discussion.

In summary, we agree with ISS's own results but we are left scratching our heads about findings at Refinitiv, Sustainanalytics, MSCI and S&P (actual scores are not made public so we used the proxy of colours to make the point).

Matching those scores helps make a few observations:

- Looking at the 62 names with poor sustainability scores according to AlphaValue, there is not a single stock on which the 5 score providers are aligned.
- There are 35 stocks for which there seems to be an agreement between ISS and AlphaValue.
- There are 23 names with a maximum divergence between ISS and AlphaValue. Conversely, ISS is rather in sync with Refinitiv and Sustainanalytics (see table below) where it diverges from AlphaValue.
- We investigated AlphaValue's own metrics and the verdict is quite direct: those stocks which are not matching AlphaValue's sustainability requirements do so because of governance weakness (not enough independent board members, all of the same feather) and because they fail to provide some of the essential environmental data.

For the sake of exhaustivity, we also looked at potential divergences on good scores (102 stocks universe). Here again the consistency with ISS is high (but for 10 stocks), and so is it with Sustainanalytics, Refinitiv and MSCI. Most differences only exist for issuers where the corporate structure is changing (data capture problem presumably). On the positive side, as would be expected, everybody agrees.

Our point does not differ from the regulator's view: inconsistency of results and a suspicious inconsistency where results are negative.

For a conclusion, we throw in our deep conviction as an experienced traditional equity research body. ESG /Sustainability metrics are not worth the pain if governance is trashed by a given issuer: without good governance, sustainability is likely to remain a feel-good intent. Governance is where there seems to be a gap between data providers as the concept of proper governance is highly sensitive to the stakeholders' profile when reaching a judgement.

62 names on which AlphaValue begs to differ

FIRM	ALPHAVALUE	ISS	Refinitiv	Sustainanalytics	MSCI	S&P RobecoSAM
ACCOR SA	3					
ADP	3					
ARKEMA	3					
BASF SE	3					
BAYER AG-REG	3					
BEIERSDORF AG	3					
BIOMERIEUX	3					
BOLLORE	3					
CARREFOUR SA	3					
COLRUYT SA	3					
SAINT GOBAIN	3					
CONTINENTAL AG	3					
COVESTRO AG	3					
CREDIT AGRICOLE SA	3					
DEUTSCHE LUFTHANSA	3					
DIASORIN SPA	3					
EDF	3					
ENI SPA	3					
EXOR NV	3					
GBL SA	3					
HERA SPA	3					
HERMES INTERNATIONAL	3					
ICADE	3					
INDITEX	3					
KONE OYJ-B	3					
LANXESS AG	3					
MARKS & SPENCER GROUP PLC	3					
MERCK KGAA	3					
NEXT PLC	3					
ORANGE	3					
PORSCHE	3					
PUMA SE	3					
RAIFFEISEN BANK	3					
REPSOL SA	3					
RHEINMETALL AG	3					
RYANAIR HOLDINGS PLC	3					
SAFRAN SA	3					
SBM OFFSHORE NV	3					
SCOR SE	3					
SOLVAY SA	3					
SWATCH GROUP	3					
TELECOM ITALIA SPA	3					
TELEPERFORMANCE	3					
TOTAL SE	3					
UBISOFT ENTERTAINMENT	3					
VALEO SA	3					
VEOLIA ENVIRONNEMENT	3					
VOESTALPINE AG	3					
ACKERMANS & VAN HAAREN	2					
ACS	2					
BANK OF IRELAND GROUP	2					
BOUYGUES SA	2					
CARL ZEISS MEDITEC	2					
CD PROJEKT	2					
EURAZEO	2					
FRESENIUS SE & CO KGAA	2					
HEIDELBERGCEMENT AG	2					
NATIXIS	2					
SEB SA	2					
THYSSENKRUPP AG	2					
YARA INTERNATIONAL	2					
SIEMENS HEALTHINEERS	1					

About AlphaValue

Founded in 2007, AlphaValue has become the world's leading provider of Independent European Equity and Credit Research, helping money managers to generate ideas and assess the risks and opportunities within their mid to large cap portfolios. Our team of 30 leading analysts covering c. 450 stocks across Europe including 60% of the Stoxx 600, use a proprietary valuation model to provide a disciplined, consistent research framework. Proud of our independence – With no execution business or financing/banking relations with issuers, our recommendations are agnostic buy vs sell, with an average of 42% of sell recommendations, at any one time.

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