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A Funds Europe survey in partnership with Linedata

The Fund Oversight Challenge

HELPING ASSET MANAGERS MEET THEIR NAV OVERSIGHT, ESG AND DATA MANAGEMENT OBLIGATIONS

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Contents

05 Foreword
07 Highlights
09 Shining a light on NAV oversight
13 Regulatory pressure
14 Technology
17 ESG and the data challenge
21 Data issues
22 Conclusion
24 Case study
26 Survey methodology

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Foreword

A DEFINING MOMENT FOR THE INDUSTRY

The importance of robust fund oversight has been in the spotlight for many years, but this focus has increased of late due to multiple factors – the pandemic, the rise of ESG funds, regulatory requirements around fair value and investor demands for more transparency.

Of particular interest is the process of net asset value (NAV) oversight, an essential tool in assessing the daily value of a fund.

The pandemic has shown just how important this oversight process is. It has also demonstrated the need to have a reliable alternative source for a 'contingent' NAV – for business continuity, regulatory compliance, and good governance.

Meanwhile there has been a rapid rise in impact investing and the demand for sustainable products which has led to greater regulatory scrutiny on ESG funds in Europe and the US.

This is why we commissioned this research project – to assess the different approaches adopted by asset managers and the operational challenges they face both generally and for the NAV oversight process specifically.

The results give reason for encouragement but also show that more must be done to improve the process. For example, almost all asset managers we surveyed use some form of alternative NAV – however, too few of them use systematic NAV oversight approaches or have back-up/contingent NAV or even full shadow NAV capabilities.

The use of spreadsheets for NAV oversight is a worrying finding as is the relatively low use of exception management and workflow tools.

But there are also positive findings to suggest a more efficient approach to NAV oversight is likely soon. Firms are happy to use third parties (ManCos, fund administrators and tech vendors) for either primary or alternative NAVs. And few (just 18%) see cost as a barrier to their NAV oversight processes.

This is a defining moment for the industry, marked by rapid technological change, the 'mainstreaming' of ESG, and changes to the nature of work. How firms handle these challenges and opportunities will define their future success.

With oversight and ESG in the spotlight, there are parallels with the evolution of Ucits, where significant industry-wide effort to strengthen rules and implement improved processes has increased investor confidence and made Ucits funds an international gold standard for investment. Perhaps in five years' time, we will look back at this (post-)pandemic period as a similar turning point.

Aldric Dupaïs
Global Head of Fund Services at Linedata

funds tech

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The fund oversight challenge

WHAT THIS SURVEY REVEALS

Highlights

Fund managers face more scrutiny than ever from both regulators and investors on how they value their funds, investments and portfolios. At the same time, the valuation process has become more complex through greater use of multi-asset funds where data is harder to come by. And recent market volatility has added to the complexity. How are firms coping with these challenges, especially when it comes to calculating and verifying a fund's net asset value (NAV)?

Funds Europe, in association with Linedata, surveyed the industry to provide answers to these questions. Among its main findings:

NAV oversight

• The majority (54%) of firms use a third-party fund administrator to produce their NAV, while 38% do this internally.
• Managers' two biggest pain points are the delays in receiving NAV from external providers (41%) and managing data providers (also 41%).
• 51% use systematic NAV oversight while 49% use spreadsheet checks. Just 15% use full shadow NAV, while only 13% use contingent or back-up NAV.

Technology

• 74% say that Covid-19 has not had a lasting impact on their operations.
• 53% say that data management is their biggest operational challenge in terms of NAV production, while 26% cited NAV validation.
• More than half (53%) do not use workflow and exception management as part of their NAV production process.

ESG and data challenges

• 56% say that technology and data infrastructure will be the focus of their investment over the coming 12 months.
• 55% say they plan to significantly increase their ESG product offerings. However, 55% provide just minimal tracking and reporting of their ESG funds currently, while 18% use none at all.
• 79% plan to invest more heavily in their ESG infrastructure over the next 12 months.
• Data is the biggest challenge around ESG, more specifically lack of standards (51%), data availability (49%) and data inconsistency (41%).

Shining a light on NAV oversight

DETERMINING A FUND'S NET ASSET VALUE IS A VITALLY IMPORTANT PROCESS – BUT OUR INDUSTRY SURVEY FOUND PLENTY OF ROOM FOR IMPROVEMENT.

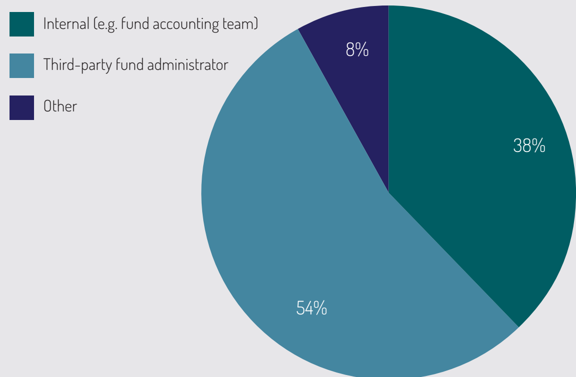
NAV OVERSIGHT IS A CRITICAL process for asset managers but one where best practice is still developing. Various factors affect the approach taken, including the size of the organisation, embedded systems and practices, whether NAV production is performed internally or outsourced to a third party, and pressure (or lack thereof) from regulators, investors and other stakeholders.

The starting point is of course NAV production. Our survey (figure 1) shows that more than half (54%) of respondents are using a third party to produce their NAVs. However, a significant number (38%) still produce their own value. Both approaches present challenges. On the one hand, the valuations process has become more complex as funds increase in both number and complexity. This has led many firms to turn to third parties both for their expertise and to reduce their overheads. On the other hand, outsourcing a process to a third party creates problems over control.

These issues are highlighted in the survey (figure 2). The biggest pain points for firms, when it comes to NAV production, stem from the use of third parties. The most cited problems were delays in receiving NAVs from external providers (41%), and managing data providers (41%). Errors in NAV production were also cited by 26%. However, delays and errors in NAV production are also a problem with internal systems and teams, as both issues were highlighted by 28%.

What these figures suggest is that there is still a significant issue with NAV timeliness and accuracy, whether produced in-house or externally.

1. Who produces the NAV for your fund(s)?

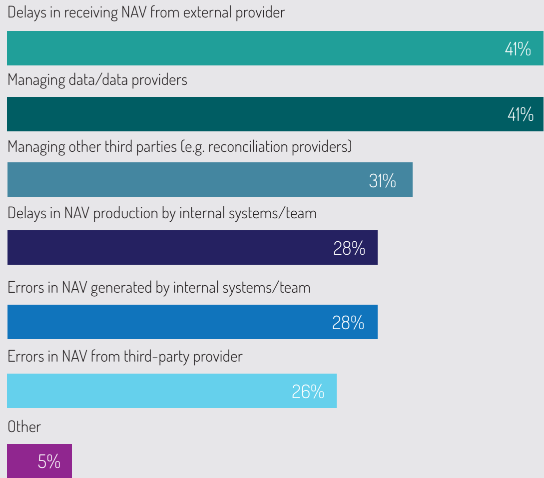


CONNECTION POINTS – Various factors affect how firms approach NAV oversight.

These issues came to the forefront when the Covid-19 pandemic sparked global market turbulence and a shift to remote working. While most firms adapted quickly to the new operational model, remote working did lead to NAV publication delays in the short term, and the need to rethink business continuity planning (BCP) and operational resilience.

Given these concerns, one would have expected a higher percentage of firms to have a robust oversight solution in place. Our survey (figure 3) shows that just over half (51%) of respondents have systematic NAV oversight in place, while a very small number (5%) do not carry out any additional validation at all.

Significantly, just under half (49%) use spreadsheets for such checks. In this day and age, spreadsheets are rarely able to provide the accuracy and scale and sophistication needed for something this important.



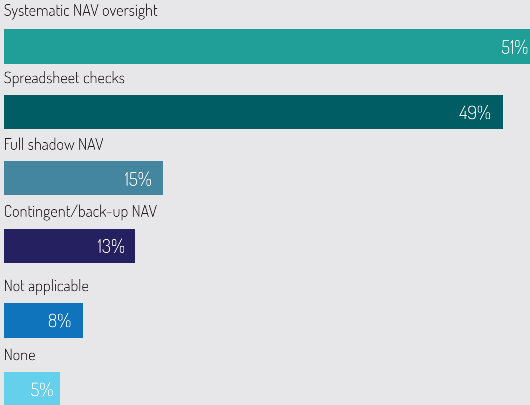
"What these figures suggest is that there is still a significant issue with NAV timeliness and accuracy. These issues came to the forefront when the pandemic sparked global market turbulence and a shift to remote working."

"Best practice would be to avoid using spreadsheets for NAV oversight," says Matt Grinnell, product manager at Linedata. "Regardless of where the NAV is struck, firms should also ensure true segregation of duties between the teams and technologies used for NAV production versus oversight."

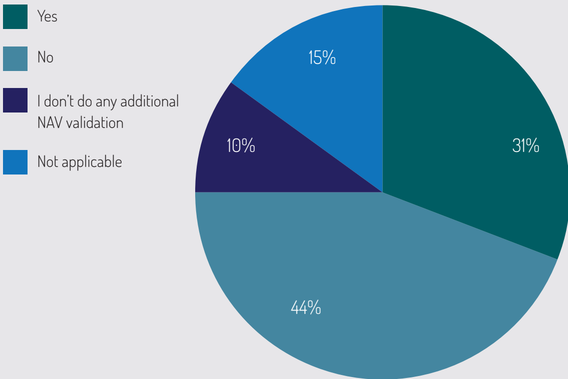
However, cost is an inevitable and unavoidable factor in such operational decisions, says Grinnell.

Another factor to consider is the complexity of new instruments, especially derivatives, which can require pricing on a manual basis. Eventually these financial products develop and mature to the point where there is standardised pricing. But by then, a newer instrument has arrived requiring more manual pricing. Consequently, it may be unlikely that the use of spreadsheets can be removed entirely but their use can certainly be

3. What additional validation is carried out in relation to the NAV calculation, if any? (Select all that apply)



4. If you indicated in the previous question that additional NAV validation is carried out, does this additional validation come from the same source as your primary NAV?



significantly reduced from 49%.

A much smaller number use a full shadow NAV (15%). The cost for this is significant: almost as much as it costs to produce a primary NAV. Nor is it easy to do.

> *"Best practice would be to avoid using spreadsheets for NAV oversight. Firms should also ensure true segregation of duties between the teams and technologies used for NAV production versus oversight."*
>
> *MATT GRINNELL, LINEDATA*

You need a significant amount of data, such as corporate actions, that is often difficult to capture.

A more cost-effective alternative has developed in the past few years – contingent NAV. This takes a more analytical approach using algorithms and acts as a reasonability check. Because it is always running, firms have another NAV on hand if the primary NAV is unavailable.

Contingent or back-up NAV is used by just 13% of survey respondents, but there is an expectation that this will increase in the coming years. Grinnell says that more RFPs are referencing contingent NAV, possibly driven by increased regulatory interest and awareness of NAV production risk.

The survey also shows that almost a third (31%) rely on

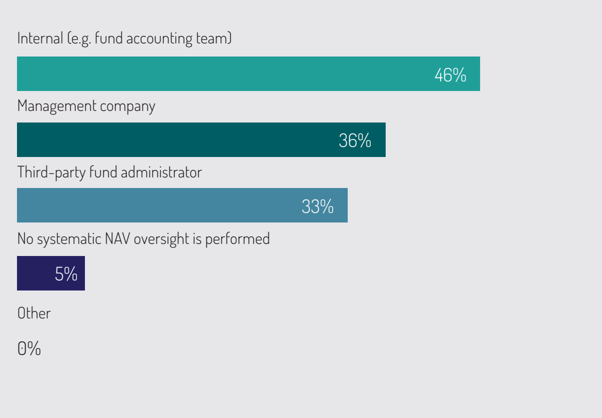
the same source for their NAV oversight as for their primary NAV (figure 4). This appears to go against the main principle of data oversight and controls. Also worrying, less than half (44%) use another source for the NAV validation.

The survey shows that this is still an evolving area (figure 5). When it comes to performing NAV oversight, the answers are fairly evenly divided between three options – internal (46%), fund administrator (33%) and management company (36%). This shows there is currently some overlap in how oversight processes are conducted. According to one respondent, the variation in answers shows that NAV oversight is still in a relative state of immaturity.

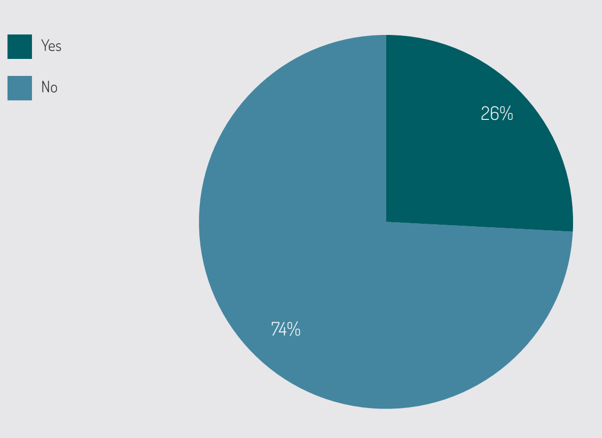
It also underlines the fact that there are many influences on firms' approaches to NAV oversight – such as risk appetite, operational governance, cost, and regulation. Respondents mentioned fund scale and complexity as a reason to use third-party applications for NAV oversight. At the same time, there is concern about a prescribed approach to NAV

> *"My nightmare is ending up in the Financial Times with a headline like 'XYZ pays fine of millions of sterling to the FCA for insufficient oversight of outsourced processes.'"*
>
> *ASSET MANAGER*

5. Who performs the 'NAV oversight' function for your fund? (Select all that apply)



6. Has Covid-19 had any lasting impact on your operational processes?



oversight. Any rules or best practice must be flexible enough to account of all the factors involved – from the firm's risk appetite to the complexity of the process, the maturity of instruments involved, local regulations and practices, such as swing pricing, and even the functionality of a firm's accounting system.

It is important to remember that asset managers retain the responsibility for NAV oversight even if they have outsourced its production to a third party. Fiduciary duty, stewardship, fear of reputational damage and concerns over regulatory penalties have all been cited as drivers for an increased demand for independent oversight of NAV in the coming months.

A 2020 report from research consultant Celent cited an unnamed asset manager who conceded that "my nightmare is ending up in the *Financial Times* with a headline like 'XYZ pays fine of millions of sterling to the FCA for insufficient oversight of outsourced processes'".

Regulatory pressure

Regulatory pressure for NAV oversight has been evident for some time. A 2013 Thematic Review by the UK's Financial Conduct Authority (FCA) called for better monitoring of firms' outsourced processes, which included NAV calculation.

The FCA followed this up in 2017 and found a number of concerns around the NAV process, namely that too few firms were devoting enough time to checking their NAV calculations.

For example, it found that a number of asset managers with many funds on offer and who outsourced the daily NAV strike to service providers had, in some cases, as little as 30 minutes to feed price data to fund distributors after NAVs were produced, meaning some firms neglected to carry out checks.

"It is not acceptable for firms to fail to retain the necessary in-house valuation expertise post outsourcing," stated the FCA in its 'Outsourcing in the asset management industry' review findings. "In the absence of adequate oversight, valuation errors could occur and investors in the fund could miss out on returns they should have received," it added.

Nor is the FCA alone. The Central Bank of Ireland has focused on asset managers' outsourced processes, including NAV calculation.

Meanwhile in the US, the

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>
> *FINANCIAL CONDUCT AUTHORITY*

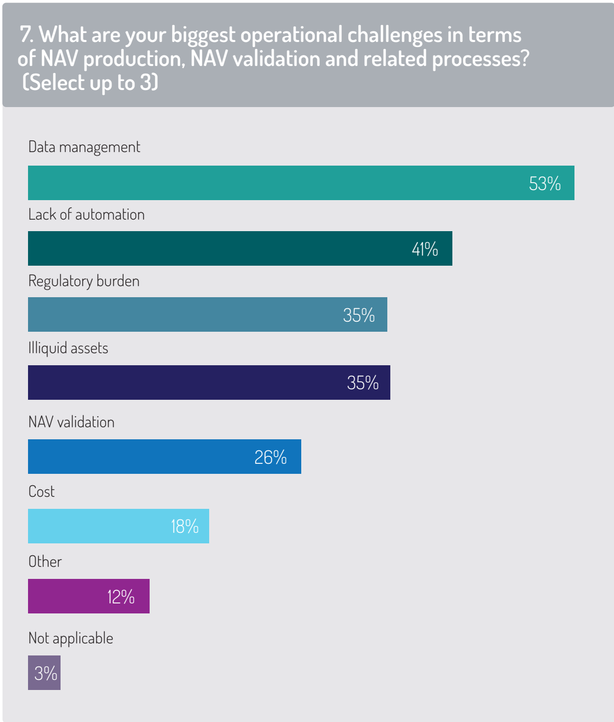
Securities and Exchange Commission has introduced measures designed to modernise the 'fair value' process. In December 2020, it passed Rule 2a-5 under the Investment Company Act of 1940, which makes asset managers responsible for assessing material risks associated with fair value and overseeing and evaluating any pricing services used. In essence, the fund's board will be responsible for valuations oversight.

The issue of NAV oversight has also been highlighted by the Covid-19 pandemic. In June 2020, fund manager Invesco called for new NAV providers with better analytics for its bond ETFs. The call came after the March lockdown and resulting market turmoil left a number of NAV providers unable to accurately adjust their pricing

methods and a dislocation between bond ETF prices and the underlying bonds by as much as 8%.

Technology

Our survey results (figure 6) show that the majority (74%) of firms have not suffered any lasting impact on their operations. This is in keeping with the general trend in financial services as a result of the pandemic. Business contingency plans kicked in and critical processes such as NAV calculations held up over the longer term, even though there was some initial disruption in the early weeks of the lockdown. Some of this was down to technical adjustments and some of it was a result of the severe volatility in the market that made it difficult to price assets accurately regardless of any technology issues.



From an operational perspective, the pandemic has proved to be an opportunity to rethink longstanding practices. Firms managed very quickly to move from paper-based back-office processes performed in heavily populated offices to digitally driven remote working. The pandemic also accelerated the adoption of automation, as firms were forced to address operational inefficiencies.

Responses in the survey show that firms have ceased paper-based reviews and data checks. Many firms are now entirely paperless as a result of the pandemic. Faxes are no longer sent because there was no one in the office to take them out of the machine.

The pandemic also highlighted the importance of business continuity planning (BCP) and contingency. Firms will have reviewed their BCP strategy to see where more work needs

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to be done. Regulators have also noted this. In the UK, the main financial regulators – the FCA, the Prudential Regulation Authority (PRA) and the Bank of England – have issued new rules for operational resilience. These require all financial services firms to review their processes, including NAV production and oversight, identify their vulnerabilities and put suitable contingencies in place. The SEC has announced similar plans, as well as a greater focus on how firms determine the fair market value of their funds, in case of operational failures.

So, while there was no market crisis at the outset of the pandemic and no long-term operational impact from Covid-19 for 74% of firms surveyed, there is no reason to be complacent. To the contrary, there are plenty of opportunities to act on what has been learned about new ways of working and the potential to develop new operating models.

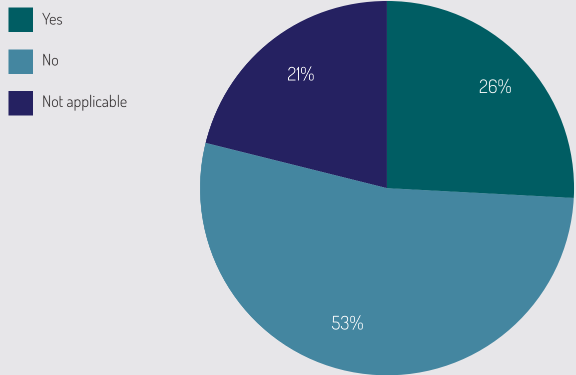
When asked to select their biggest operational challenges in terms of NAV production, 53% cited data management (see figure 7). The second most cited challenge was a lack of automation (41%). It is possible that the two are related – data management is made harder by a lack of automation, and automation is harder to implement because there are so many sources of data, many of them unstandardised. This is most evident in figure 10, where 47% of firms said they use four or more sources of vendor data.

Not all firms can afford to invest in automation; however, cost was cited by just 18% as an operational challenge. Technology does generally become more accessible as it matures, and the technology associated with digital processes and automation is no longer new and is becoming well established. Furthermore, the pandemic has helped make technology investment more compelling. Projects that have been pending for long periods have been given approval and IT budgets have been given priority.

Meanwhile, regulatory burden was cited as an operational challenge by more than a third (35%). While reporting requirements can be a driver for investing in operations and automation, the ongoing expense of regulation can complicate the business case and make it difficult to free up the necessary capital.

Additional comments related to the lack of software functionality, which results in multiple manual or Excel calculations. These exceptions will be especially prevalent in illiquid assets (cited by 35%

8. Do you use a workflow and exception management platform as part of your NAV production process?



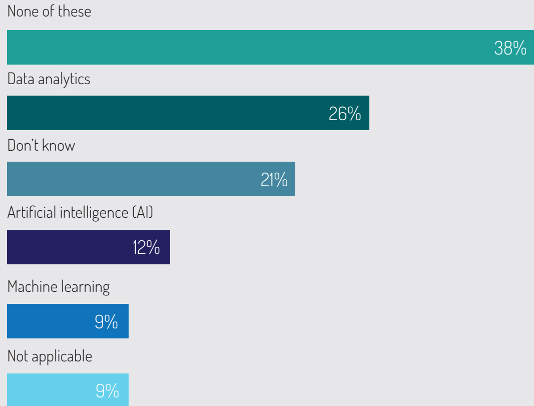
as an operational challenge). Finally, NAV validation was also cited by 26% as one of the biggest operational challenges while "existing NAV validation product" was cited by one of the respondents. This suggests that the NAV oversight market is still relatively immature.

The immaturity of the market was underlined by the relatively minimal use of workflow and exception management platforms (figure 8). If we take away the 'not applicable' responses, there are twice as many firms *not* using workflow and exception management as part of their NAV production process as there are using these platforms.

For Linedata's Grinnell, this is one of the most surprising results in the survey. "The fact that firms are not applying automated technology to their exceptions management means that there is a lot of wasted time," he says. Not only is it an issue of operational efficiency, there is also the operational risk to consider. Without the use of technology, a lot of exceptions may go undetected for longer periods. "The longer a problem goes undetected, the bigger the impact and the more severe the remedy," says Grinnell.

"The fact that firms are not applying automated technology to their exceptions management means that there is a lot of wasted time... The longer a problem goes undetected, the bigger the impact."

MATT GRINNELL, LINEDATA



Finally, the survey suggests new technology like artificial intelligence (AI) and machine learning (ML) do not (yet) widely feature in the NAV production process (figure 9). Only data analytics (26%) featured in any significance, which is perhaps surprising given that NAV is such a data-driven process.

The use AI and ML has been largely confined to the front office thus far. This is not surprising, says Grinnell, given that the front-office traders and portfolio managers drive the bottom line. "But we do expect that technology to trickle down and to appear in the oversight and compliance process at some stage in the future. There is a lot of useful data within those functions. AI and ML are good at recognising patterns and there is potential to apply business intelligence to that data and predict where risks may occur."

This suggests there is still plenty of room for development around NAV oversight. For example, there could be a significant advantage for firms that are able to use the valuations process for something beyond mere compliance, for example insight into market movements and trends.

That said, there is significant value to be gained from making the oversight process more robust and more efficient. Regulatory requirements around valuations are likely to increase and the importance of NAV validation and the use of back-up/contingent NAV will therefore be increased, so technology will have a vital role to play here.

Henri Berthe, subject matter expert, Europe at Linedata Fund Services, is confident that the demand for contingent NAV services will increase over time as NAV oversight becomes mandatory. "While asset managers are ultimately responsible for publishing the correct NAV for each fund, fund administrators and management companies also have well-documented roles to play," says Berthe.

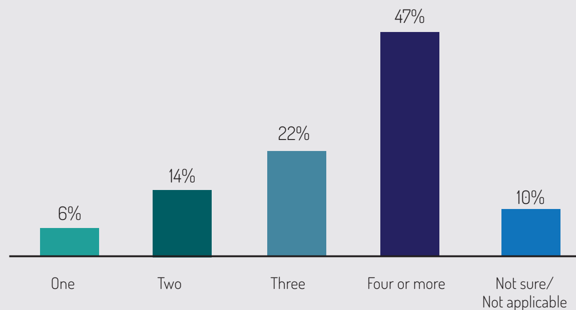
"Fund administrators must review and validate the NAV they produce because this is their core business, while ManCos that have delegated NAV production remain responsible for validating that the delegated activity is being done correctly," he adds. "Some management companies still use macros and spreadsheets for NAV validation, but this will change over the next few years, and they will need to start using more reliable, accurate, auditable systems."

ESG and the data challenge

Data has become a primary driver of technology development for asset management. Over the past few years, there has been the realisation among market participants that data is no longer an outcome but a valuable commodity in its own right. Consequently, firms are searching further and wider for data and for multiple purposes – not just compliance but for investor reporting, for product development, for operational alpha and more.

This is borne out in our survey. Our study (figure 10) shows that almost half (47%) of firms use four or more external sources for their data, be that standing data, market data, pricing data or ESG. A very small number (6%) use just a single source. While the predominant use of vendor data is a welcome development in terms of data governance, it does create some operational issues, as will become evident in later

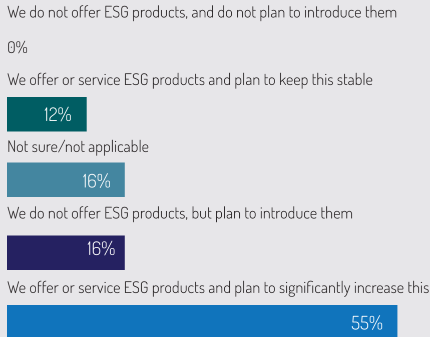
10. Approximately how many sources of vendor data (prices, corporate, standing data, ESG etc) do you use?



questions in the survey. These issues concern aggregating that data, ensuring consistency and managing the processing of that data.

These data management issues have become especially critical in ESG [environmental, social and governance] investing, where the lack of standardised data has become a critical cause of concern. It makes it harder for investors to accurately assess ESG fund performance and to compare funds. This challenge may affect the credibility of the burgeoning ESG sector, especially if it allows for so-called 'greenwashing' whereby fund managers are unable to substantiate the ESG claims they are making.

The EU's Sustainable Finance Disclosure Regulation (SFDR) was implemented earlier this year, partly in response to the unstandardised data issue. The aim was to establish a standard taxonomy, increase transparency and thereby avoid greenwashing.



> *"Some management companies still use macros and spreadsheets for NAV validation, but this will change over the next few years and they will need to start using more reliable, accurate, auditable systems."*
>
> *HENRI BERTHE, LINEDATA*

The SFDR calls on asset managers to classify their funds according to three primary categories – article 6, which makes no claims of sustainability, or articles 8 and 9, which both claim ESG credentials. Firms are then required to provide data to support these claims.

However, while it is a welcome step in the right direction, the legislation is far from perfect in the eyes of many in the industry.

"[The SFDR] comes with many challenges," says Giorgio Botta, regulatory policy advisor at the European Fund and Asset Management Association (Efama). "You have the clear benefits for investors, but it also creates more administrative burdens – it's expensive, it takes time, it takes data. You cannot fight greenwashing with estimates or gestures – you need data."

Efama is also concerned about inconsistent reporting standards and the cost of data, to the extent that it has called for a transition period for taxonomy-related disclosures in the SFDR.

The impact of the SFDR is not limited to Europe. Any US manager that wants to market their funds in Europe will have meet the regulation's

"The SFDR comes with many challenges... You cannot fight greenwashing with estimates or gestures – you need data."

GIORGIO BOTTA, EFAMA

requirements. And while the EU may be the first region to act, it is inevitable that other jurisdictions will follow. The UK, having left the EU, is planning its own rules on ESG disclosure, as is the US.

The Securities and Exchange Commission (SEC) has said that its examination of the ESG sector has uncovered shortcomings in the way that investment managers and advisers have built, pitched and monitored their ESG funds. While it has not yet passed any regulation on the subject, it has issued guidance at various times, advising that investors in ESG funds understand what they are investing in.

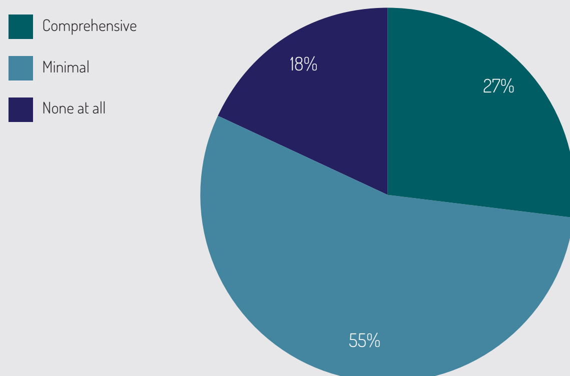
Guidance issued in February 2021 noted the data challenges around ESG funds: "There is no SEC 'rating' or 'score' of E, S, and G that can be applied across a broad range of companies, and while many different private ratings based on different ESG factors exist, they often differ significantly from each other."

The SEC also notes that some ESG fund managers may use data from third-party providers. "Some of the data used to compile third-party ESG scores and ratings may be subjective. Other data may be objective in principle, but are not verified or reliable," it states.

As became clear in our survey, ESG is now a primary focus for product development. Figure 11 shows that more than half (55%) of respondents are planning to significantly increase their ESG product offerings. This reflects a clear appetite among investors for ESG products. 2020 saw record inflows into the sector. Figures from the UK's Investment Association in November 2020 showed that in the first nine months of that year, responsible investment funds saw net inflows of £7.1 billion, 275% more than the £1.9 billion of flows for the equivalent period in 2019.

For firms that specialise in ESG, results have been good. For example, Impax Asset Management saw its assets under management (AuM) rise by nearly 50% in the six months up to March 2021. This has resulted in more ESG fund launches from managers

12. What ESG tracking and reporting do you currently provide?



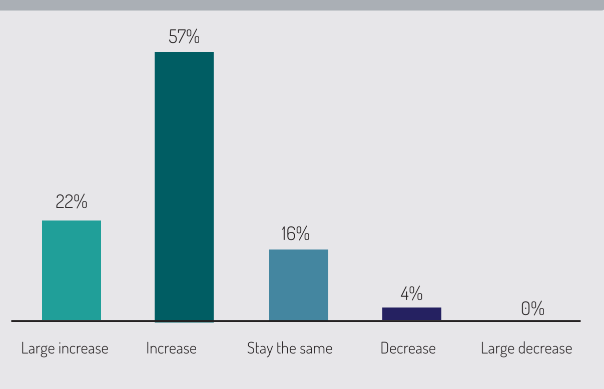
and more recruitment of ESG specialists.

However, as ESG becomes more popular with investors and more lucrative for managers, the challenges around data standardisation and valuation will only become more important and more urgent.

Transparency will be key to challenging greenwashing, but the survey shows the relatively immature state of data management within the ESG world. Figure 12 shows that only a quarter (27%) use comprehensive tracking and reporting, while more than half (55%) use minimal ESG reporting/tracking and almost one in five (18%) use none at all.

The SFDR will have a massive impact on ESG reporting, so firms have a big challenge to improve their capability in this regard. Figure 13 shows that fortunately, the vast majority of firms (79%) plan to invest more heavily in their ESG, with 22% planning to do so significantly.

> *"Some of the data used to compile third-party ESG scores and ratings may be subjective. Other data may be objective in principle, but are not verified or reliable."*
>
> *THE SECURITIES AND EXCHANGE COMMISSION*



It will be interesting to see whether they follow through on this and if there are adequate solutions and offerings out there to meet their needs. Also, do firms know how they intend to improve their infrastructure and will it be enough to meet their reporting requirements?

When respondents were asked to name their biggest challenges around ESG (figure 14), data was the common theme. A lack of standards (51%), data availability (49%) and data inconsistency (41%) all featured highly. It is also worth noting that the subjective nature of ESG was noted by a similar number (41%).

This shows the balancing act that regulators face when formulating rules and regulations around the ESG sector. On the one hand, there is a need to impose standard definitions and a taxonomy so it is possible for firms to compare one fund with another; and on the other, the rules also need to respect the subjectivity and allow managers to define their own values and ESG approach. As one ESG manager said at a recent *Funds Europe* webinar on ESG standards: "No one wants to be told what 'good' looks like."

There is also the fear that an overly prescriptive approach to ESG reporting may end up limiting the investment universe for ESG funds and negatively

affecting their performance.

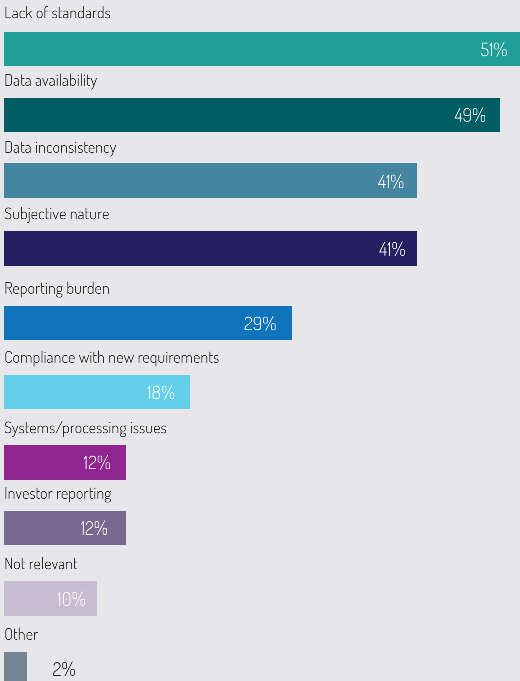
Speaking at a webinar on ESG reporting standards held by *Funds Europe*, Andrew Parry, head of sustainable investments at Newton Investment Management, said: "The reason that people buy investment products is for performance and returns, not for highly detailed reports.

"Demystifying what we do is important, but we must not lose sight of how we use that data to add value to our investors," he added. "My concern is that we will limit the freedom of choice and our investment universe in the interest of greater clarity of reporting."

> *"Demystifying what we do is important but we must not lose sight of how we use data to add value to our investors."*
>
> *ANDREW PARRY, NEWTON INVESTMENT MANAGEMENT*

Data issues

Our report echoes what is clear in the market – that there is an increase in ESG activity and there are issues with ESG data.



According to Paul Elflain, Head of Asset Management, Europe, at Linedata, it is important to appreciate the subjective nature of the ESG market and to accept that different firms will use the same data for different means. For example, says Elflain, some firms will use ESG scores and ratings to decide whether they divest from certain assets or companies, whereas others will use that same data to inform their ESG risk.

There is also a challenge for asset managers to integrate that data into their own systems and their own ESG framework, whether that is to meet compliance obligations or to validate their own ESG strategies and mandates.

This may lead to a rise in hybrid data models where an internally developed

methodology is used to define a firm's ESG strategy and then external data is used to validate that strategy. "You have to retain the flexibility to be able to score things in different ways," says Elflain.

The most likely development is that standardisation will be focused on the raw data and the definitions and taxonomy rather than a prescriptive standard for ESG ratings and scores. "There is a place for methodologies," says Elflain. "But you have to be able to prove to the market that you are doing what you say you are doing."

The hope is that, in the longer term, the SFDR and the Non-Financial Reporting Directive (NFRD) will provide more transparency and credibility to the vast array of ESG scores and encourage them to improve

"We are looking at how we can make standardisation easier and develop a subscription-based model for firms so that they do not have to do so much of the heavy lifting."

PAUL ELFLAIN, LINEDATA

their sustainability credentials.

However, one of the critical short-term concerns regarding the SFDR is the associated data cost, says Elflain, especially if these costs prove too high for the smaller boutiques.

This is where data management vendors have to pick up the slack, he adds, so that ESG does not become the sole domain of the larger and well-resourced asset managers.

"We are looking at how we can make standardisation easier and develop a subscription-based model for firms so that they do not have to do so much of the heavy lifting," says Elflain.

There are numerous implications if the industry fails to address these data challenges, he says. Firstly that they will lead to more greenwashing – that is, firms using ESG branding to promote their products without necessarily adhering to ESG principles. Secondly, if investors find that they are unable to compare different ESG funds or understand and assess the different methodologies at work, the ESG sector will lose credibility.

However, despite the fears over greenwashing, there is less cynicism towards ESG from the people most closely involved, says Elflain. "The vast majority of ESG managers believe in these concepts and believe that ESG scores are not as important as their overall objectives – to try and change corporate behaviour for the better."

Conclusion

Our survey shows that some form of NAV oversight is in place for all but a small minority of firms. However, it also shows that there is plenty of room for improvement in how this process is performed. Firms are using systematic NAV oversight and spreadsheet checks in equal measure and more comprehensive measures like full shadow NAV and contingent NAV are not widely used.

These figures suggest that we are at the start of a trend.

The survey also highlights three drivers that are making the case for better NAV oversight. Firstly, there is the pandemic. The funds industry adapted commendably to the move to remote working and proved that mass adoption of digital technology can be achieved. The case for automation accelerated and the adoption of digital processes grew massively.

The pandemic also raised the importance of contingency. Although the market proved

"The vast majority of ESG managers believe that ESG scores are not as important as their overall objectives – to try and change corporate behaviour for the better."

PAUL ELFLAIN, LINEDATA

to be remarkably resilient to extraordinary changes, the pandemic has shown that high-impact/low-probability events can happen and the right contingencies have to be in place – be that enhanced cyber security for home workers or back-up provisions for NAVs in the event of system outages, business interruptions or unprecedented market volatility.

A critical component in the rise of NAV oversight is technology. The pandemic has proved digital technology can work at an enterprise level and has made it harder to justify the use of spreadsheets and manual workarounds in all but the rarest of instances. Cost is also less of an issue as technology becomes more accessible.

There is also greater regulatory focus on valuations and oversight. The likes of the FCA and the SEC are putting new rules in place to ensure accurate valuations and fair value.

And we have witnessed greater investor interest in validation and data. This is most clearly seen in the rise of sustainable investing and ESG. A lack of standards around the multitude of ESG ratings and scores is making it harder for investors to compare funds and failing to prevent so-called 'greenwashing'.

If asset managers are to compete in markets like ESG and attract a new breed of demanding and socially conscious investors, they will need to prove their ESG credentials and demonstrate, through accurate and transparent data, that they can validate their mandates.

Taking all of these factors into consideration, we can reasonably expect the adoption of cost-effective options like contingent NAV to grow in increasing numbers in the years to come. **f**e

Fast, accurate and efficient

A Q&A WITH **SAMUEL KUBORN**, MANAGING DIRECTOR, PRODUCT AND PROFITABILITY FOR TRUSTEE, DEPOSITARY AND FUND CORPORATE SERVICES AT RBC INVESTOR & TREASURY SERVICES.

Has Covid-19 impacted your operations?

There was little impact operationally since most of our processes were already automated globally. For example, our technology and operating model provides us with the ability to produce the NAVs from multiple locations.

In March 2020, we switched to working from home overnight. Although this change was abrupt, our ability to make this transition seamlessly demonstrated the effectiveness

"We switched to working from home overnight. Although this change was abrupt, it our ability to make this transition seamlessly demonstrated the effectiveness of our business continuity plan. Going forward, we will leverage this experience."

of our business continuity plan. Going forward, we will leverage this experience and the firm will offer continued flexible working conditions. There are however remaining certain regulatory

limitations for certain locations or the important to maintain employee engagement while working from home.

The survey shows that less than half (47%) use workflow and exception management while 41% cite a lack of automation as their biggest operational challenge. Do these figures surprise you?

For over ten years, we have had an automated NAV oversight process in place which allows us to monitor the accuracy of NAVs before they get published. The main benefit we get from NAV oversight is speed, accuracy and efficiency. We can release the NAVs quicker for the benefit of our clients.

Is there a place for machine learning (ML) and artificial intelligence (AI) in the NAV oversight process?

I definitely think there is. Workflow and exception management is a necessity, especially when you are operating at scale, and AI and ML will help with the remaining gaps that we have not been able to close.

For example, ML, which allows a machine to automatically learn from past data, can be applied to some of the more complex processes that are difficult to standardise or automate today.

AI, which is doing human intelligence tasks but faster, is likely to be used further in the future in our industry.

What is your biggest ESG data challenge?

ESG is complex and norms don't exist. The industry is still organising itself and its main challenge is to manage ESG in a standardised, transparent and comprehensive way. Each of these three aspects is equally important and challenging.

Lastly, current ESG metrics give varying results and this lack of consistency between ESG data sources may give rise to cherry-picking. One rating agency may tell you a company is ESG-compliant while another could make it appear on your exclusion list.

What is the implication of a lack of standard ESG data?

If there is no trust in the underlying data, it will affect the credibility of ESG funds and if there is no pressure to publish reliable data, there might be a risk for greenwashing to occur.

We can, however, expect that in the next two to three years, the market will evolve and a global standard will emerge with an abundance of ESG data available in the public domain.

"Workflow and exception management is a necessity, especially when you are operating at scale, and AI and ML will help with the remaining gaps that we have not been able to close."

Will there be a cost to solving this ESG data issue?

What is costly today is the lack of a standard data model and getting access to reliable data. I believe that when reliable ESG data will be copiously available due to multiple data sources, then that should put some pressure on the costs.

What is the key to solving these data issues?

Although ESG is complex, the industry is restructuring and change will take time. The SFDR and the EU taxonomy, which comes into effect in January 2022, is a welcome mandatory step towards standardisation and transparency. **f**e

Survey methodology

A total of 70 investment professionals participated in the survey, conducted online during Q2 2021. Respondents were asked to say what type of organisation they represented:

Asset manager: 29%
Management company: 21%
Third-party fund administrator: 21%
Depositary/custodian: 11%
Asset owner: 3%
Other: 14 %

Respondents in the "other" category were asked to specify the nature of their work. Responses included financial technology, legal, financial research, regulator.

The respondents worked in these regions:

United Kingdom: 21%
Rest of Europe: 63%
Asia (ex China): 6%
US: 6%
Other: 3%

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