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European Commission drafts benchmark to establish common ESG criteria

Article

What's the latest? The European Commission (EC) drafted a proposal for its much-anticipated sustainable investing taxonomy right at the close of 2021.

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The taxonomy creates a common set of criteria to determine which economic activities are sustainable, giving investment firms a metric to **screen potential investments**.

- The proposal met with outrage from environmental organizations after the EC said it would label **natural gas and nuclear energy** as green due to their transitional capabilities on the road to decarbonization and meeting emissions targets.
- Other international organizations are also drafting taxonomies to address the lack of common criteria: The **Green Digital Finance Alliance (GDFA)** and the **Swiss Green Fintech Network** released a draft taxonomy to help investors, policymakers, and technology providers consistently assess fintechs' environmental impact.

Why does this matter? **Environmental, social, and governance (ESG)** investing has taken the asset management industry by storm amid rocketing investor interest—but the space has been plagued by accusations of greenwashing.

- Global inflows into ESG funds exceeded **$178 billion for Q1 2020**, surging roughly **27% year over year (YoY)**, according to **Morningstar** research. Yet each of the **20 largest ESG-labeled funds holds an average of 17 investments in fossil fuel producers**—including oil giants like **ExxonMobil**, per research from **The Economist**.
- The absence of a **common global benchmark** that sets out which companies should qualify for ESG-labeled funds is a leading cause of greenwashing.
- Investment firms rely on third-party ratings agencies that use different standards to score companies—which leads to inconsistencies across portfolios.
- Greenwashing threatens to derail this investment strategy: A lack of investor faith in these funds might lead them to **divert capital away from sustainable projects**.

The role of fintech: Common standards will help to mitigate inconsistencies in company scoring and reporting, but **data scarcity** remains a thorn in ESG's side. Fintechs can help with this.

- **Almost half of global investors** say they are inhibited by a lack of ESG data, per 2021 research from Capital Group.
- And **41% of global firms say finding accurate data** is a top challenge, per a June 2021 Capgemini survey.

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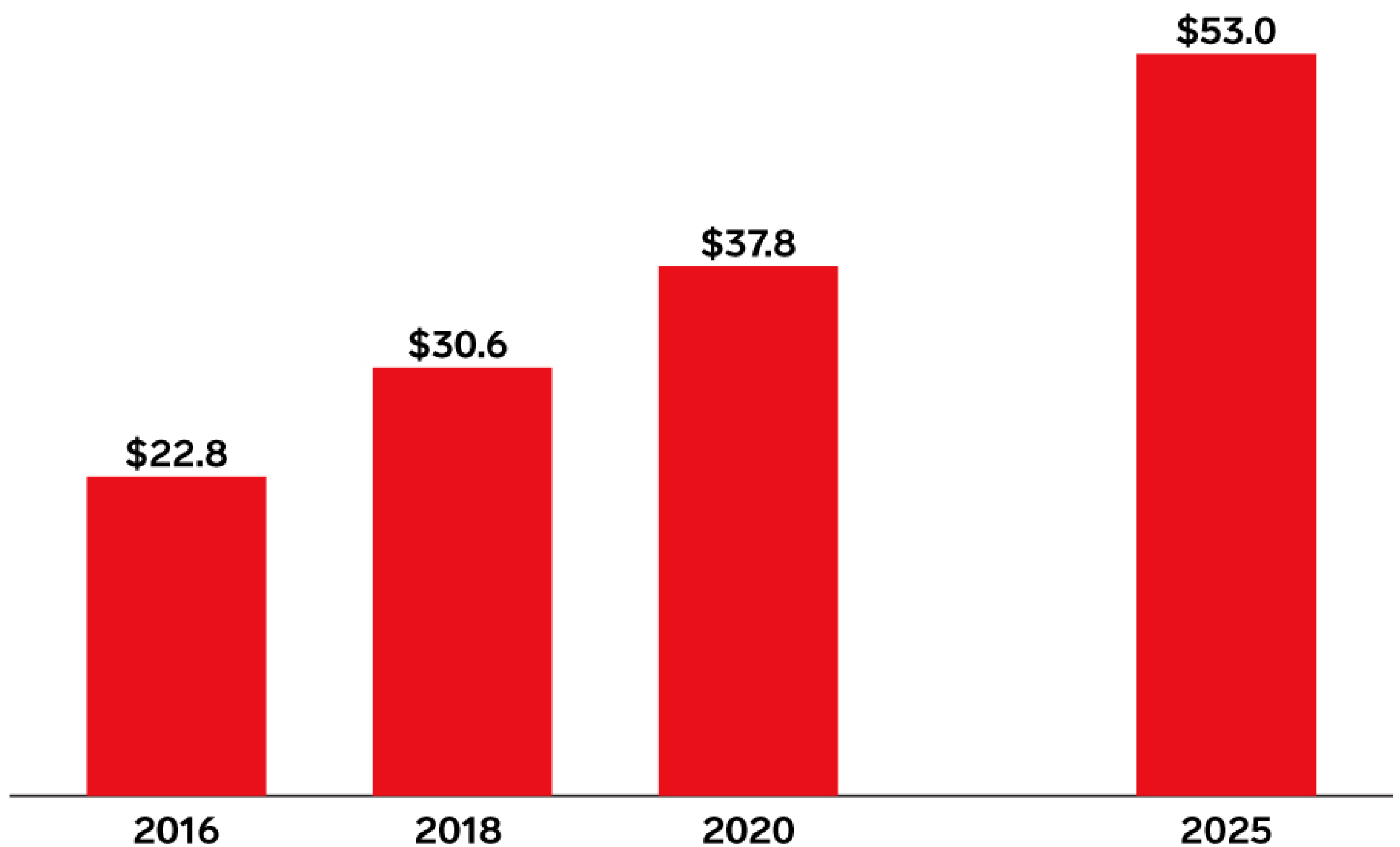
- So little reliable, quality data exists because investors are stuck with infrequent, nonfinancial company disclosures.
- **Asset managers need more data,** and they'll need to mine alternative sources to compensate for the current scarcity.
- Fintechs that offer AI-powered analytics will help asset managers create new insights from sources like **news outlets or social media**—generating more abundant ESG data. ESG-specialist fintech **novisto**, for example, offers mining solutions that automate data collection.



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