THE ORIGINS AND CONSEQUENCES OF THE ESG MONIKER

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ESG Stocks

Environmental | **Social** | **Governance**

"ESG" stands for environmental, social, and (corporate) governance -- the three criteria to evaluate a company's sustainability performance.


WHAT KIND OF ESG INVESTOR ARE YOU?
SOURCE: NEW YORK LIFE INVESTMENTS (SEP 2020)
SUSTAINABLE INVESTING
EXCLUSIONARY INVESTING
“I want to screen out controversial companies or sectors that do not meet my sustainability criteria.”
INCLUSIONARY INVESTING
“I want to seek out companies that are ranked highly in their sector based on sustainability criteria.”
ESG INTEGRATION
“I want to integrate ESG factors and traditional factors to assess the risk/reward profile of my investments.”
IMPACT INVESTING
“I want to invest in companies that attempt to deliver a measurable social and/or environmental impact alongside financial returns.”
ESG INVESTING

QZ Quartz

✦ Startups need ESG — The Forecast — Quartz

in the end most ESG/CSR is just cheap talk

Marc Andreessen @pmarca

Dirty clothes are ESG.

> **Dan McArdle** @robustus · 3h
> Replying to @pmarca
> Related: clothes dryers in the US use more energy than all bitcoin mining.
>
> So not doing your laundry must be *very* ESG, if you (incorrectly) believe btc mining is so bad.

10:09 PM · Apr 2, 2022 · Twitter Web App

Elon Musk @elonmusk

Replying to @pmarca

I am increasingly convinced that corporate ESG is the Devil Incarnate

1:14 AM · Apr 3, 2022 · Twitter for iPhone

Elon Musk @elonmusk · May 18

Exxon is rated top ten best in world for environment, social & governance (ESG) by S&P 500, while Tesla didn't make the list!

ESG is a scam. It has been weaponized by phony social justice warriors.

15.7K 47.2K 297.4K

OPINION | COMMENTARY

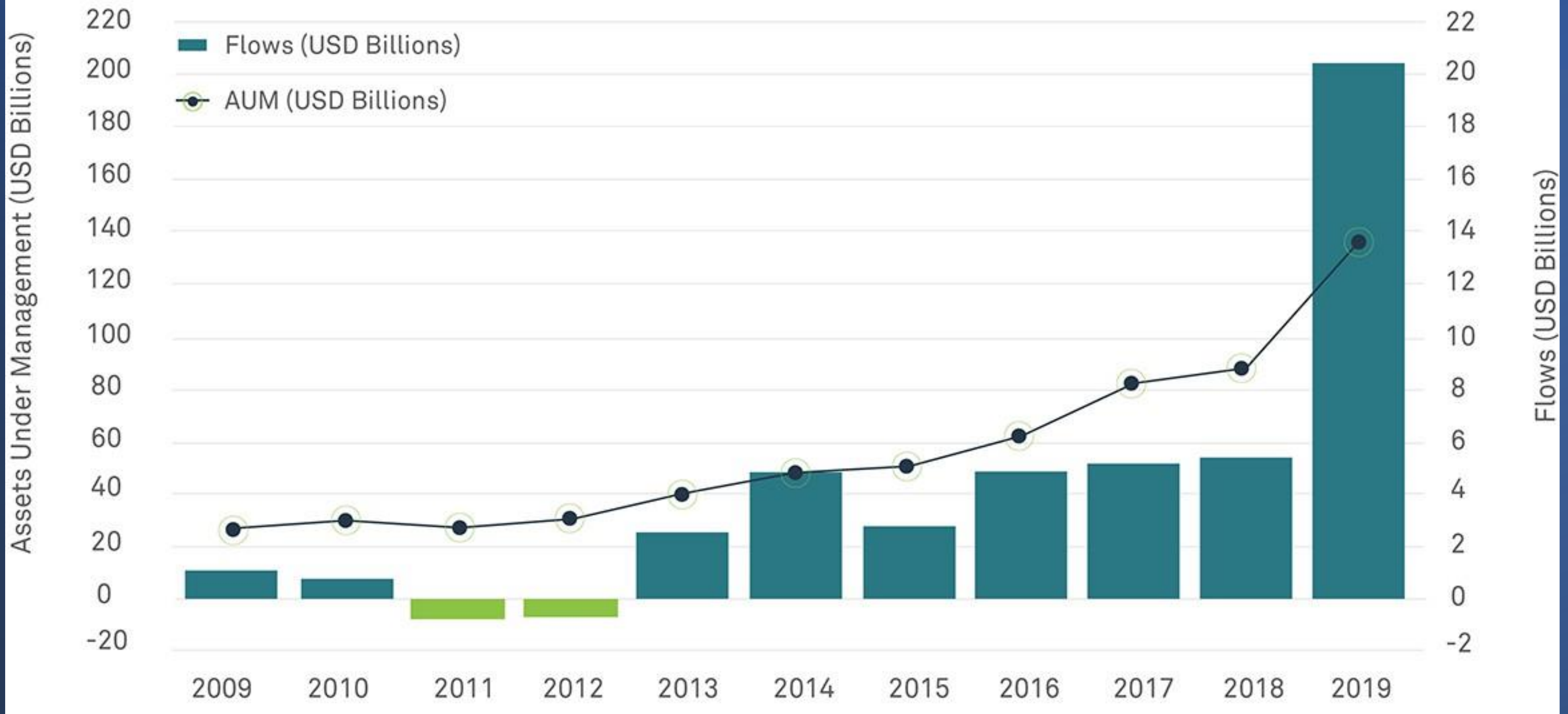
Republicans Can Stop ESG Political Bias

The progressive left is using it to advance goals it could never hope to achieve at the ballot box.

By Mike Pence
May 26, 2022 1:50 pm ET

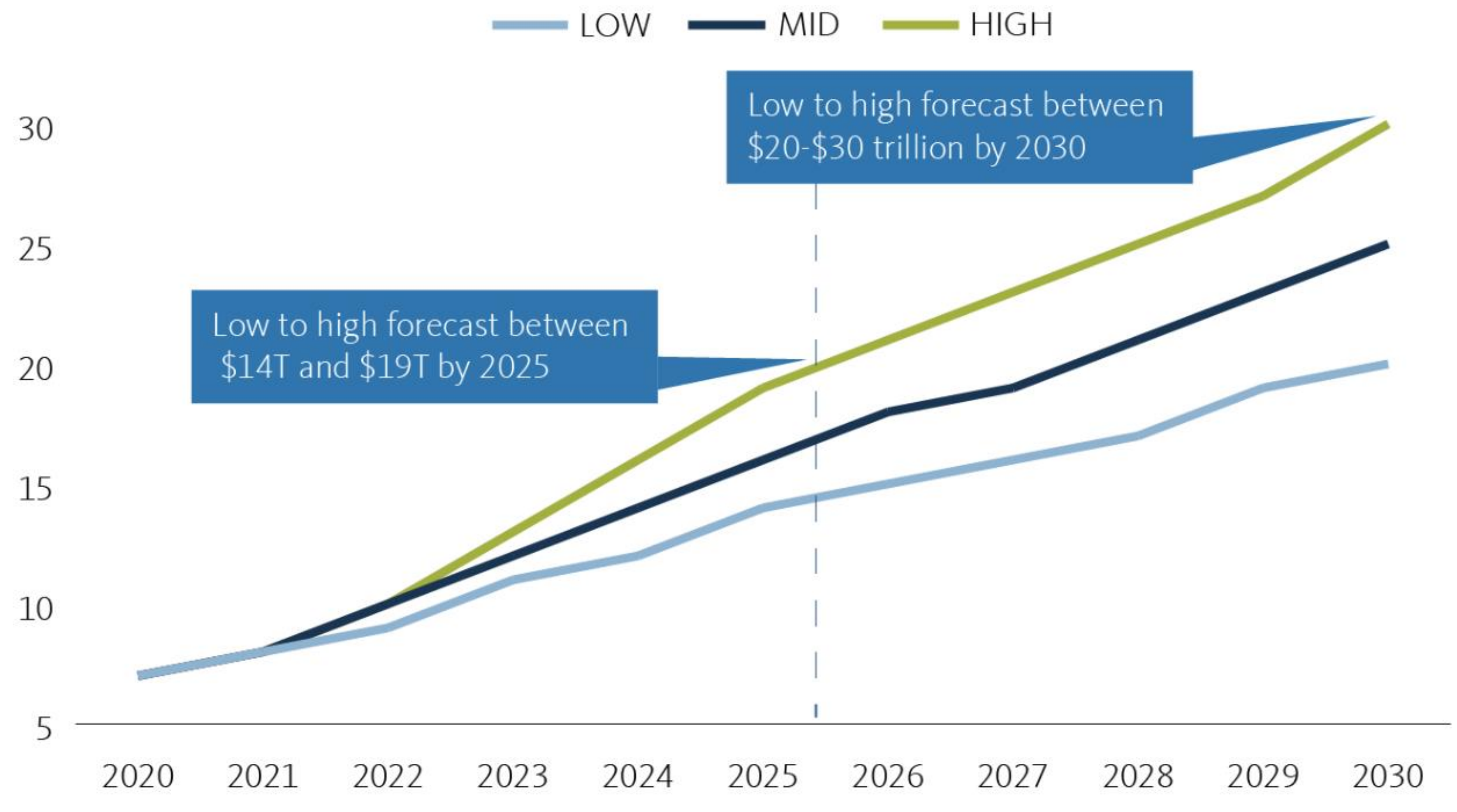
SUSTAINABLE GROWTH

Annual flows into sustainable funds exploded last year as interest in ESG picked up



SOURCE: MORNINGSTAR DIRECT, DATA AS OF 12/31/2019

Total Retail and Institutional ESG AUM Forecasts to 2030 $trn



Source: Broadridge Global Market Intelligence. Excludes money market and fund of funds. Includes mutual funds, ETFs, institutional mandates, and private funds.

Motivating Questions

- Where did ESG come from, was it defined, & what were the goals of its creators?
- Do people mean the same thing when they refer to ESG today? What are the various meanings ascribed to the term?
- What are the consequences of the strategic choice to put E+S+G together?

I. Origins & Diffusion

Brief description of the U.N. Global Compact

Launched in July 2000 by United Nations Secretary-General Kofi Annan, the Global Compact is an international initiative bringing companies together with UN agencies, labour and civil society to support ten principles in the areas of human rights, working conditions, the environment, and anti-corruption. Through the power of collective action, the Global Compact seeks to advance responsible corporate citizenship so that business can be part of the solution to the challenges of globalisation. In this way, the private sector — in partnership with other social actors — can help realize the Secretary-General's vision: a more stable and inclusive global economy.

U.N. Global Compact Principles

Human Rights

Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights within their sphere of influence; and

Principle 2: make sure that they are not complicit in human rights abuses.

Labour

Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;

Principle 4: the elimination of all forms of forced and compulsory labour;

Principle 5: the effective abolition of child labour; and

Principle 6: eliminate discrimination in respect of employment and occupation.

Environment

Principle 7: Businesses should support a precautionary approach to environmental challenges;

Principle 8: undertake initiatives to promote greater environmental responsibility; and

Principle 9: encourage the development and diffusion of environmentally friendly technologies.

Anti-Corruption

Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery.*

** The Secretary-General introduced this principle at the Global Compact Leaders Summit on 24 June 2004.*

Background and scope of the report

This report is the result of a joint effort of financial institutions which were invited by United Nations Secretary-General Kofi Annan to develop guidelines and recommendations on how to better integrate environmental, social and governance issues in asset management, securities brokerage services and associated research functions. The work that led to this report took place under the auspices of the U.N. Global Compact.

The Global Compact is a corporate responsibility initiative launched by Secretary-General Kofi Annan in 2000 with the primary goal of implementing universal principles in business. By establishing the link between environmental, social and governance issues and investment decisions, this report wishes to contribute to better integration of these factors in investment decisions which will ultimately support the implementation of the Global Compact principles throughout the business world.

Overall goals:

- Stronger and more resilient financial markets
- Contribution to sustainable development
- Awareness and mutual understanding of involved stakeholders
- Improved trust in financial institutions

Endorsing institutions

The report is the result of a joint initiative of the following companies:

ABN Amro
Aviva
AXA Group
Banco do Brasil
Bank Sarasin
BNP Paribas
Calvert Group
CNP Assurances
Credit Suisse Group
Deutsche Bank
Goldman Sachs
Henderson Global Investors
HSBC
IFC
Innovest
ISIS Asset Management
KLP Insurance
Mitsui Sumitomo Insurance
Morgan Stanley
RCM (a member of Allianz Dresdner Asset Management)
UBS
Westpac
World Bank Group

The institutions endorsing this report are convinced that in a more globalised, interconnected and competitive world the way that environmental, social and corporate governance issues are managed is part of companies' overall management quality needed to compete successfully. Companies that perform better with regard to these issues can increase shareholder value by, for example, properly managing risks, anticipating regulatory action or accessing new markets, while at the same time contributing to the sustainable development of the societies in which they operate. Moreover, these issues can have a strong impact on reputation and brands, an increasingly important part of company value.

“Throughout this report we have refrained from using terms such as sustainability, corporate citizenship, etc., in order to avoid misunderstandings deriving from different interpretations of these terms. We have preferred to spell out the environmental, social and governance issues which are the topic of this report.”

Sound corporate governance and risk management systems are crucial pre-requisites to successfully implementing policies and measures to address environmental and social challenges. This is why we have chosen to use the term "environmental, social and governance issues" throughout this report, as a way of highlighting the fact that these three areas are closely inter-linked.

In particular, we believe that corporate governance systems can play a key role in implementing many of the recommendations in this report, particularly with regard to better transparency and disclosure, linking executive compensation to longer-term drivers of shareholder value and improving accountability.

"This report focuses on issues which have or could have a material impact on investment value. It uses a broader definition of materiality than commonly used — one that includes longer time horizons (10 years and beyond) and intangible aspects impacting company value. Using this broader definition of materiality, aspects relating to generally accepted principles and ethical guidelines (e.g. the universal principles underlying the Global Compact) can have a material impact on investment value."

A selection of ESG issues impacting company and investment value

ESG issues relevant to investment decisions differ across regions and sectors. The following are examples of issues with a broad range of impacts on companies:

Environmental issues:

- Climate change and related risks
- The need to reduce toxic releases and waste
- New regulation expanding the boundaries of environmental liability with regard to products and services
- Increasing pressure by civil society to improve performance, transparency and accountability, leading to reputational risks if not managed properly
- Emerging markets for environmental services and environment-friendly products

Social issues:

- Workplace health and safety
- Community relations
- Human rights issues at company and suppliers' /contractors' premises
- Government and community relations in the context of operations in developing countries
- Increasing pressure by civil society to improve performance, transparency and accountability, leading to reputational risks if not managed properly

Corporate governance issues:

- Board structure and accountability
- Accounting and disclosure practices
- Audit committee structure and independence of auditors
- Executive compensation
- Management of corruption and bribery issues

Flywheel of UN Initiatives, Financial Institutions, Institutional Investors & Their Networks

- Continued meetings & outreach of WCW initiative
- UNEP FI – Freshfields Report
- UNEP FI & Global Compact launch of Principles for Responsible Investment (PRI)
- Evolution of Global Reporting Initiative (GRI)

II. Evolving and Varied Usages of ESG

- Factors for investment analysis
- Risk management
- New term or synonym for CSR (or sustainability)
- Ideological preference

III. Consequences of E + S + G

- The Flexible, Big Tent Approach of ESG and its Alignment Story:
- Globally applicable and customizable by context (e.g., corruption – board diversity)
- Evolution over time of meaning
- Big tent

III. Consequences of E + S + G

- A Combination Giving Rise to Challenges & Critiques:
- Challenges:
  - Difficulty of empirical relationship between ESG and economic performance
  - Diversity of ratings & rankings – substantial variation & can appear at odds with understood purposes of ESG moniker
  - Sustainability arbitrage
  - Tensions between E & S – business model or industry
- Critiques: confusion, unrealistic expectations, greenwashing, ineffectual, etc.
- Proposals to change the ESG term (EESG, ES no G, etc.) → creation of new taxonomies or terms