

Is ESG Investing a Thing of the Past?

Singapore Actuarial Society

20 June 2023

The growth of ESG Investing

FINANCIAL TIMES

APRIL 27 2006

- ESG, SRI, ethical investing have been around since at least 18th Century
- Institutionalisation started in the early 20th Century
- Pace increased in recent years

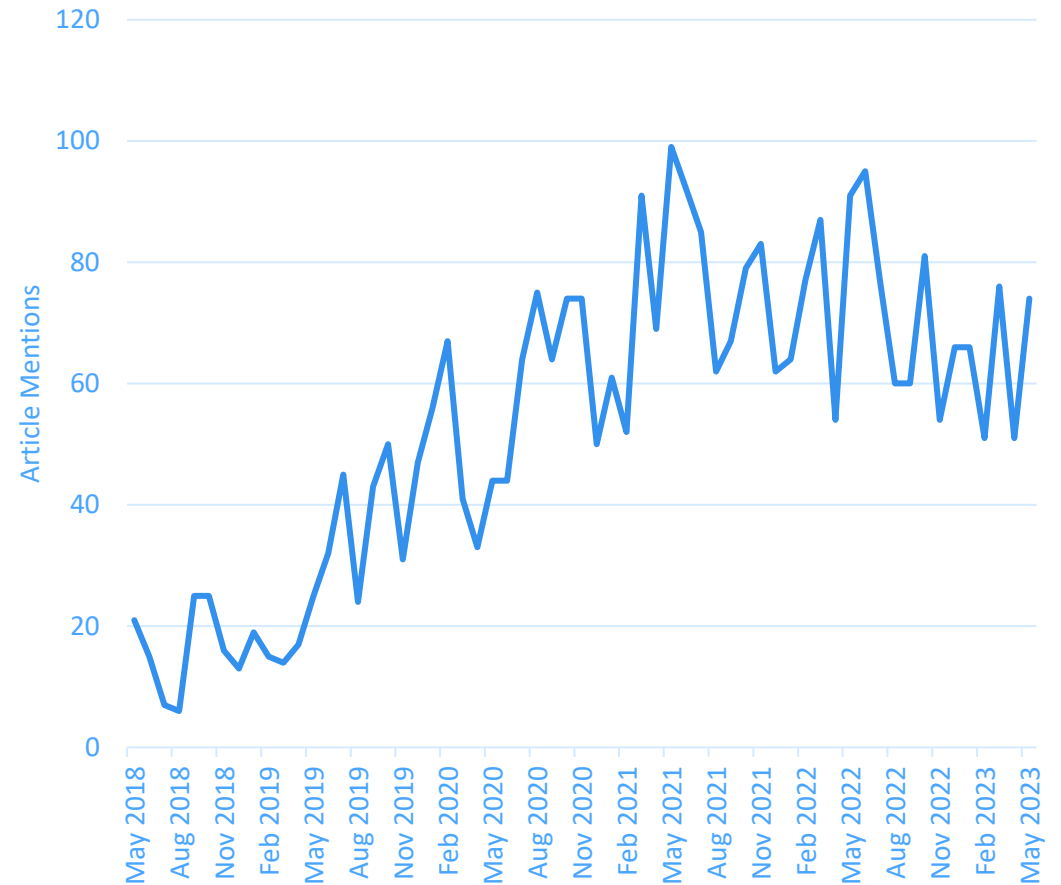
Pension funds worth more than \$2,000bn will commit themselves on Thursday to the first global charter placing environmental, social and governance (ESG) standards at the core of their investment strategies.

The 32 funds from six continents include some of the world's largest long-term investors and represent more money than all hedge funds and private equity groups combined. They will sign six "Principles for Responsible Investment", founded on the belief that such standards are material to assets' long-term value.

The funds say it is their fiduciary responsibility to demand these standards of the companies in which they invest through more sophisticated analysis and active ownership policies.

How much is ESG talked about?

- Significant growth in FT articles on ESG since 2018...
- ...though a gradual decline over the last couple of years



Source: ft.com

However, there are challenges

- Greenwashing
- Inconsistent definitions of ESG
- Conflicts of interest
- Significant geographic differences in uptake

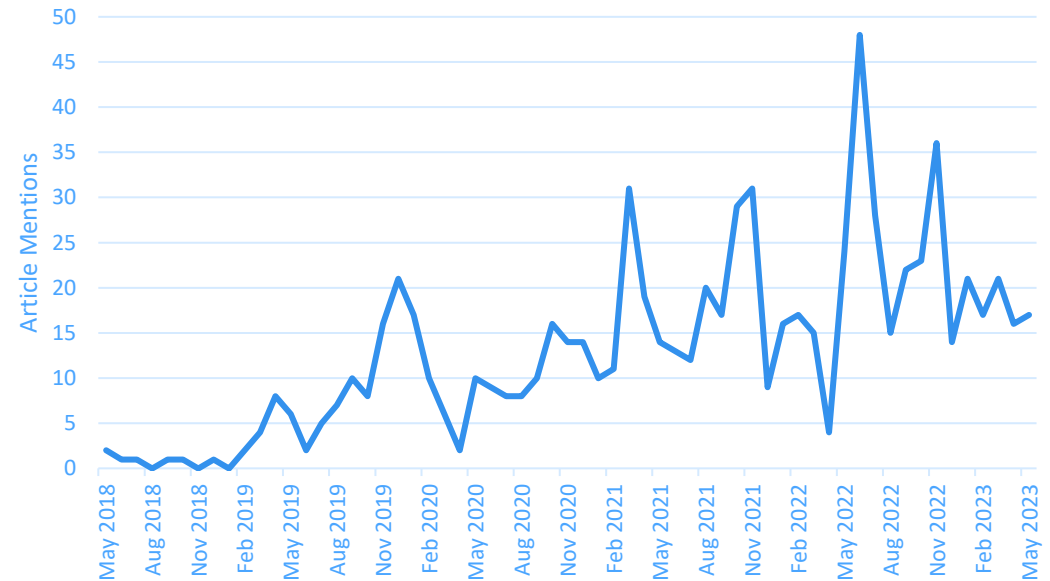
The growth of greenwashing

Although there may be a large element of “greenwashing”, lip-service paid to environmental concepts as a marketing ploy, in all of this, it is hard to escape the impression that a substantial proportion of investment professionals in Europe at least are changing their ideas about the intersection between investment and responsibility.

- First mentioned in 2009...
- ...but downplayed
- However, increasingly seen as a problem

FINANCIAL TIMES

OCTOBER 18 2009



Source: FT.com

Inconsistency

- Greenwashing linked to ESG definitions
- Reflects gaming of ratings...
- ...but also different weights for E, S & G
- Sustainbility found more than 600 ratings
- ...and KPMG found from 125 and 150...
- ...with 10-15 major providers*
- Average correlation between 400 firms' ESG scores = 0.34**

RA.1

Number of corporate ESG ratings from selected providers
More than 8 000 companies rated on average

ESG rating provider	Number of companies rated
Bloomberg	11 700
FTSE Russell ^a	7 200
ISS	4 000
MSCI	8 500
Refinitiv ^b	10 000
S&P Global	7 300
Sustainalytics	12 000

Note: Number of corporate ESG ratings from selected ESG rating providers based on publicly available information. The numbers may cover more than one ESG rating product type.

^a Number of rated securities.

^b Number of companies for which ESG data are available.

Sources: Company websites, ESMA.

Source: ESG ratings: Status and key issues ahead; "ESMA Report on Trends, Risks and Vulnerabilities; No 1, 2021

* ESG ratings: Status and key issues ahead; "ESMA Report on Trends, Risks and Vulnerabilities; No 1, 2021

** "Variability in ESG ratings makes a murky picture for investors", Esgclarity.com, 31 May 2022

An example



Elon Musk  
@elonmusk · [Follow](#)

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.

7:09 PM · May 18, 2022 

 [Read the full conversation on Twitter](#)

 294.3K  Reply  Share

[Read 15.5K replies](#)

	Exxon	Tesla
Sustainalytics	36.5 (“high risk”)	28.5 (“medium risk”)
S&P (high=better)	36	28
ISS – ESG	C-	C+
ISS – Governance (high=more risk)	4/10	10/10
ISS – SDG (high=more risk)	16.4 (-10 to +10)	-4.7 (-10 to +10)
Moody’s – ESG	3 (“moderately negative”)	2 (“neutral to low”)
Moody’s – E	5 (“very highly negative”)	2 (“neutral to low”)
Moody’s – S	5 (“very highly negative”)	3 (“moderately negative”)
Moody’s – G	2 (“neutral to low”)	3 (“moderately negative”)

Source: Variability in ESG ratings makes a murky picture for investors, Esgclarity.com, 31 May 2022

- ...and he's still going...
(screenshot from 14 June)



A screenshot of a tweet from Elon Musk (@elonmusk) posted 7 hours ago. The tweet text is "Why ESG is the devil ...". Below the tweet is a quote tweet from Aaron Sibarium (@aaronsibarium) posted 18 hours ago. The quote tweet text reads: "NEW: From S&P Global to the London Stock Exchange, tobacco companies are crushing Tesla in the ESG ratings. How could cigarettes, which kill over 8 million a year, be deemed a more ethical investment than electric cars? One answer: Tobacco's gone woke. freebeacon.com/latest-news/ho ...". Below the quote tweet is a link "Show this thread". At the bottom of the tweet are icons for replies (4,744), retweets (13.7K), likes (75.7K), and views (14.5M), along with a share icon.

Elon Musk   @elonmusk · 7h
Why ESG is the devil ...

Aaron Sibarium  @aaronsibarium · 18h
NEW: From S&P Global to the London Stock Exchange, tobacco companies are crushing Tesla in the ESG ratings. How could cigarettes, which kill over 8 million a year, be deemed a more ethical investment than electric cars?
One answer: Tobacco's gone woke. [freebeacon.com/latest-news/ho](https://www.freebeacon.com/latest-news/ho)
...
[Show this thread](#)

4,744 13.7K 75.7K 14.5M

Conflicts of interest

- Many ratings providers also construct indices
- Potential conflict?
- Motivation to improve scores to broaden index?
- Changes are coming – particularly in the EU

Bloomberg June 8, 2023

EU Puts ESG Rating Firms on Notice as Major Overhaul Planned

- Ratings providers will be asked to keep scoring units separate
- Measures follow years of unregulated growth in the industry

Enter the EU

- EU is at the forefront of ESG investment
- Three key areas
 - Requirements for rating companies (previous slide)
 - Requirements for funds
 - Requirements for companies

What is an ESG fund?

- Several ways in which a fund can be an ESG fund
 - Negative screening
 - ⇒ avoiding securities with certain ESG characteristics
 - Positive screening
 - ⇒ invest in securities with certain ESG characteristics
 - Thematic (not necessarily ESG)
 - ⇒ seek to benefit from long-term ESG trends
 - Indirect impact
 - ⇒ invest in companies committed to positive ESG outcomes
 - Direct impact
 - ⇒ invest in companies to direct them to positive ESG outcomes

ESG Funds in the EU

- Affected by SFDR: Sustainable Finance Disclosure Regulation
- Defines three types of fund:
 - Article 6: no sustainability scope
 - Article 8: promote environmental or social characteristics (“light green”)
 - Article 9: have sustainable investment as their objective (“dark green”)

SFDR Introduction

- Level 1
 - Came into force on 30 June 2021
 - Required firms to publish statements on principal adverse impact (PAI) and due diligence policies
- Level 2
 - Came into force on 1 January 2023
 - Introduced mandatory reporting template on a range of indicators for the PAI statement
- Many funds moved from Article 9 to Article 8 following Level 2...
- ...which might suggest prior greenwashing?

EU ESG regulation for companies

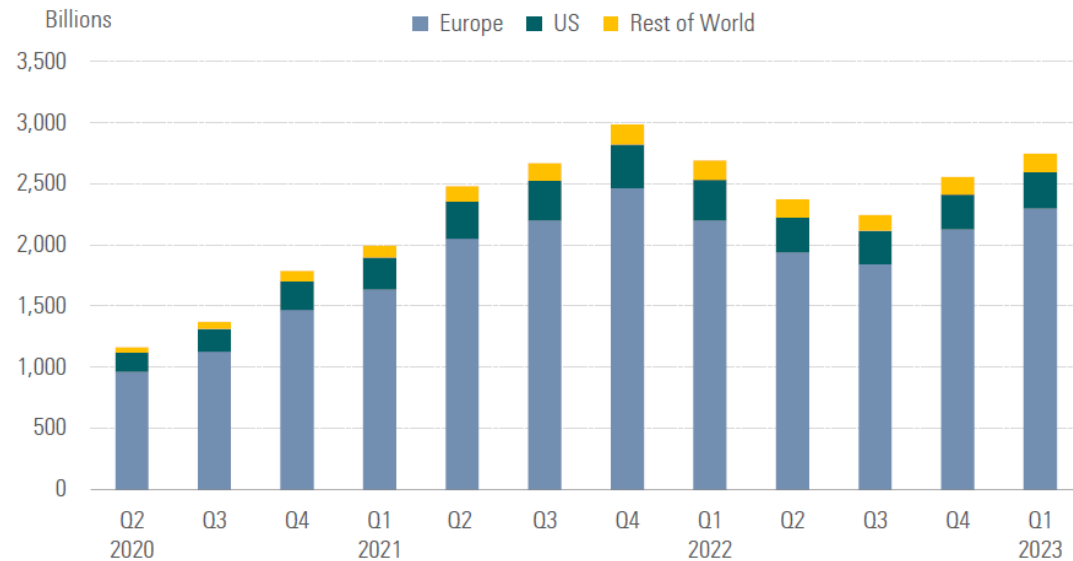
- Corporate Sustainability Reporting Directive (“CSRD”)
- Came into force on January 5, 2023, affecting
 - EU companies
 - non-EU companies with minimum EU net turnover
 - Companies with EU-listed securities
- Rules phased in from January 1, 2024 to January 1, 2028.
- Disclosure required on
 - impact of sustainability-related factors on operations
 - how business model impacts sustainability factors
- Scope or reporting includes climate, water/marine resources, circular economy, pollution and biodiversity

UK also has corporate ESG rules

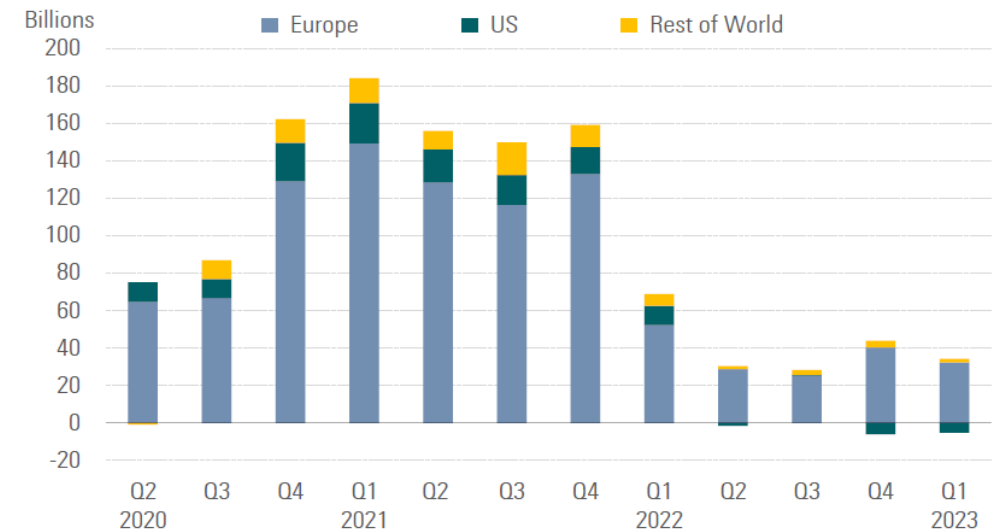
- Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 (CR22) came into force on 6 April 2022
- Created mandatory climate-related disclosures including:
 - Descriptions of how the company manages climate-related risks
 - Descriptions of actual and potential impacts of climate-related risks on company
 - Companies can avoid certain disclosures, but clear explanation needed
- Applies to UK companies with more than 500 employees which are
 - Public company trading on a UK regulated market/AIM
 - Private company with turnover above £500 million
 - Certain Limited Liability Partnerships (related regulations)
- Task Force on Climate-Related Disclosures (TCFD) aimed at same firms
- Disclosures around governance, strategy, risk management
- Mandatory since April 2022

Europe is the main home of ESG funds

Sustainable Fund AUM (USD)



Sustainable Fund Flows (USD)

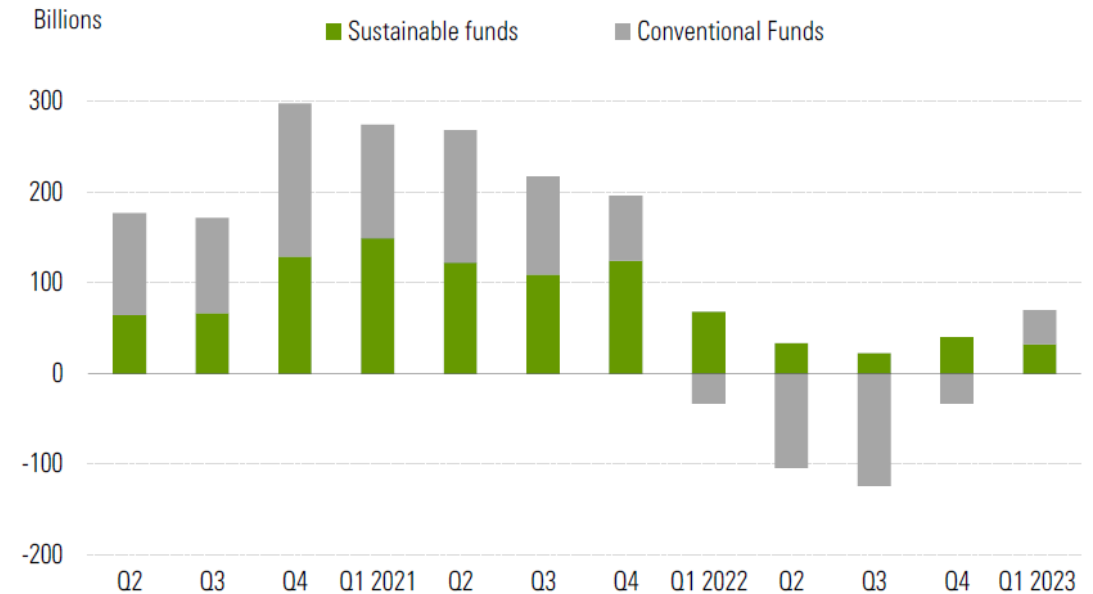


Source: www.morningstar.com, 2023

Sustainable vs conventional fund flows

- In the EU, sustainable funds a significant proportion of total flows...
- ...but this is not true elsewhere, especially US

Sustainable vs conventional fund flows in the EU (USD)



Source: www.morningstar.com, 2023

Global importance of ESG

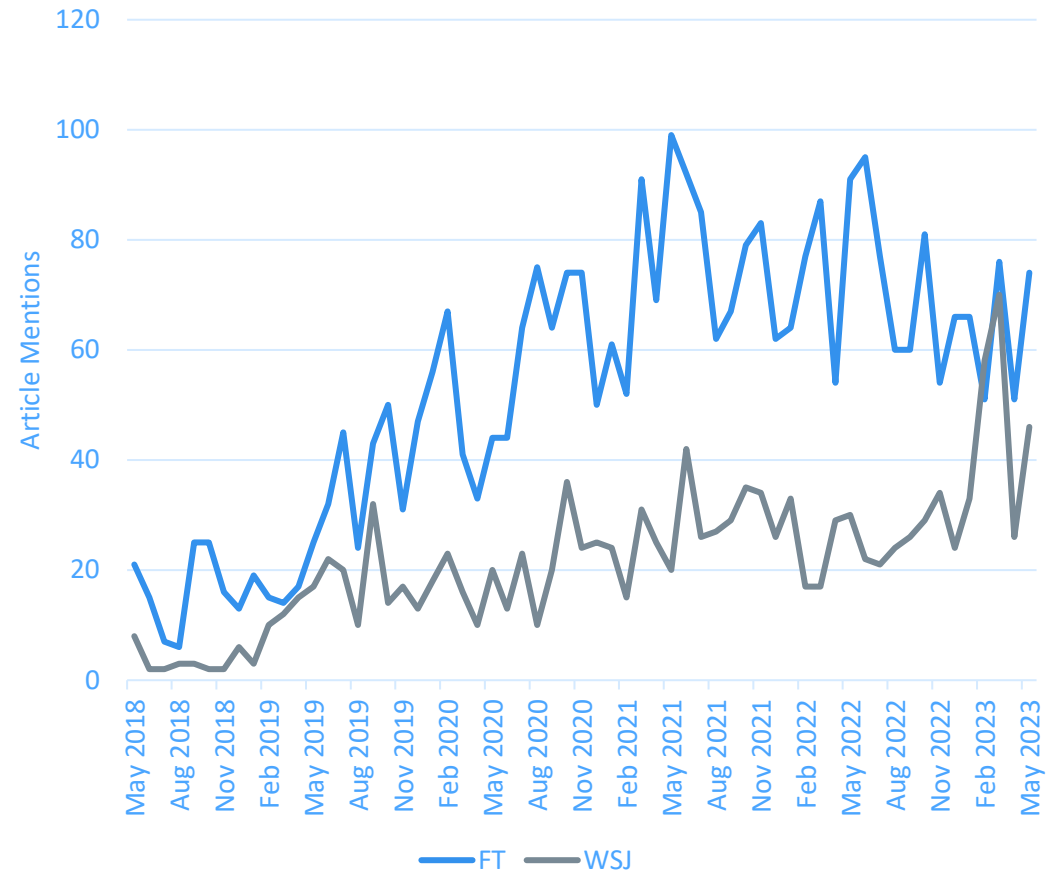
- As previous slides show, investment in ESG funds significantly lower in the US
- ESG regulations also more limited, generally voluntary
- Private sector pension plans allowed (but not required) to consider ESG factors in proxy voting from November 2022
- SEC guidance in January 2020 references several ESG metrics as examples of new required disclosures...
- ...as well as board and employee diversity metrics

Key challenges/opportunities

- Challenges
 - Lukewarm acceptance (or regulatory push) outside Europe
 - Continued confusion/skepticism over ESG scores
- Opportunities
 - Many companies have EU exposure, so EU rules will bite
 - Increasing disclosures will provide positive ESG incentives
 - Segregating ratings teams will help improve credibility
- However, until (unless?) US investors get on board, ESG will struggle to gain global acceptance

How much is ESG talked about in the US?

- Started slowly...
- ...but making up ground?
- However, given it has been a topic for three centuries, optimism should be tempered...



Source: ft.com, wsj.com

Thank You!

Paul Sweeting 