ESG Investing: A Call for Standardization

Opinion Snapshot

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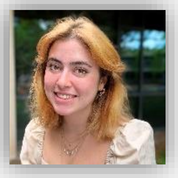

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Introduction

Clients and consumers are adamantly demanding social and environmental accountability from their investors and financial services as long-term dangers from globalizing markets continue to arise. As a result, ESG-investing has become one the fastest growing investment strategies across the world with sustainable portfolios taking in nearly ¼ of all new money in ETFs and mutual funds in 2020 alone.[1] ESG standards have transitioned from a trend to a robust strategy that aligns both societal needs and risk management with sustainable returns.

ESG investing is an investing style that incorporates environmental, social, and governance considerations as a core component of the investment process.[2] According to research, there are three overarching objectives within ESG-investing that distinguish it from traditional investing: it is favorable towards long-term financial performance. ESG-investing also explicitly aligns personal values with investments and generates direct positive impact through capital allocation.[3]

The standardization of ESG investing is imperative as Millennials and Gen Zs are quickly approaching the age where they can invest. These young investors are significant because they are expected to generate GDP growth greater than the remarkable amount Baby Boomers are known for.[4] With European countries leading the trend in ESG standardization, many others across the globe are quickly following. However, many financial systems, including that in the U.S., are increasingly discovering difficulties and opportunities within their own complex economic system. One major challenge to ESG investing is the threat of greenwashing to shareholder security, as a universal method of data collection has yet to be established. Our paper aims to discuss the younger generation's concern for this threat and address other recommendations for financial institutions moving forward.

This report outlines the status quo of ESG investing, challenges and opportunities, and forecasts the most impactful trends.

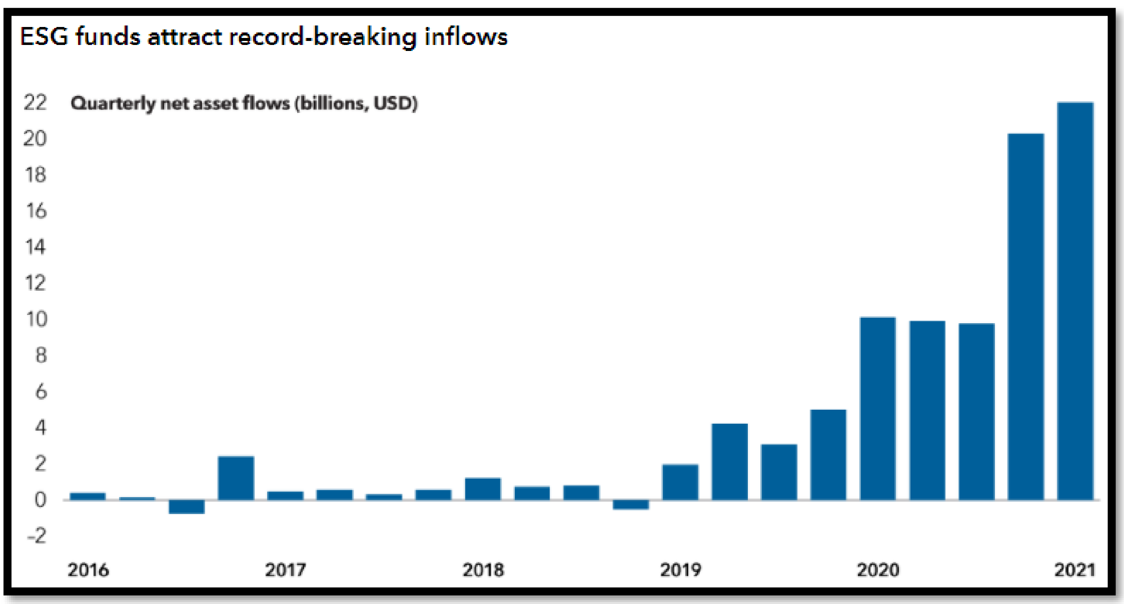
Context and Definition of ESG

The three components that make up ESG are environmental, social, and governance. Environmental matters deal with issues such as climate change, deforestation, and the depletion of natural resources. Social matters delve into the expectations companies set for their suppliers in terms of management of human rights and labor issues, as well as how companies treat their employees regarding diversity and labor standards. Lastly, governance related matters tackle issues within the company such as board composition, shareholder rights, and executive pay.

While investors select stocks and funds based on a set of standards through positive and negative screening under socially responsible investing (SRI), ESG investing incorporates a broader set of due diligence questions regarding environmental, social, and governance actors' influence on financial performance. According to Statistica, most investors focus on the environmental aspect of ESG when compared to other components.[5] However, it is important to note that all components of ESG are complex and are often linked together.

Looking back a decade ago, only a few specialist firms were dealing with ESG funds. Today, almost every asset manager has incorporated ESG investing into their investment strategies or is catching up to do so. As seen in Figure 1, there have been a record-breaking inflow to ESG funds in the past five years.[6] In 2020, ESG funds attracted a net flow of $51.1 billion, which is more than double the total for 2019 ($21.4 billion) and a ten-fold growth from 2018 ($5.4 billion).

Figure 1: Net Asset Growth of ESG Funds (2016 to 2021)



Source: Capital Group, Morningstar. As of March 31, 2021, includes U.S. mutual funds and ETFs, but excludes fund of funds.

Industry Trends

Sustainable investing is a vital component for a long-term strategy that is attuned with future industry challenges and opportunities. For example, ESG considerations are increasingly being incorporated into investment risk management processes. Risk managers are challenged with rapidly changing regulation and sophisticated cyber threats, as well as with investor sentiment that rapidly changes and expands to non-traditional assets[7]. Another future trend shaping the world of asset management in the upcoming years is the regulations under the new administration which will manifest in new compliance approaches asset managers should account for[8]. Furthermore, regulations that increase ESG disclosures by companies will increase the quality of ESG data available to investors for incorporations into the investment process.

The COVID-19 pandemic has further sharpened the focus on financial market risks that fit within the realm of the ESG sphere. According to a 2020 J.P. Morgan investor survey, 55% of respondents expect the pandemic to be a positive catalyst for ESG momentum in the next three years[9]. Bloomberg Intelligence predicts that Global ESG assets will exceed $53 trillion by 2025, which will make up more than one third of the projected total asset under management.[10] Positive projections on the growth of ESG portfolios reflect the common sentiment among industry professionals that ESG investing has become mainstream.

Industry experts expect a more holistic integration of ESG strategies in portfolios. Scholars at the NYU Stern, analyzing the link between ESG and financial performance in 1,000 research papers from the past five years, observed improved financial performance due to ESG over prolonged periods of time.[11] Research in the field points towards better risk-adjusted performance for ESG funds when compared to traditional investments. These findings seem to apply in general to economic downturns as high rated ESG mutual funds outperform low rated funds.[12]

ESG works as a mitigating tool for these challenges and enables some of the aforementioned opportunities by creating value through multiple mechanisms. ESG strategies can reduce (operating) costs as sustainable practices often promote resource efficiency and lead to promising long-term investments. It also increases the quality of the workforce of companies and the industry in general because it attracts a broader talent pool and motivates employees.[13]

Current Investment Strategies

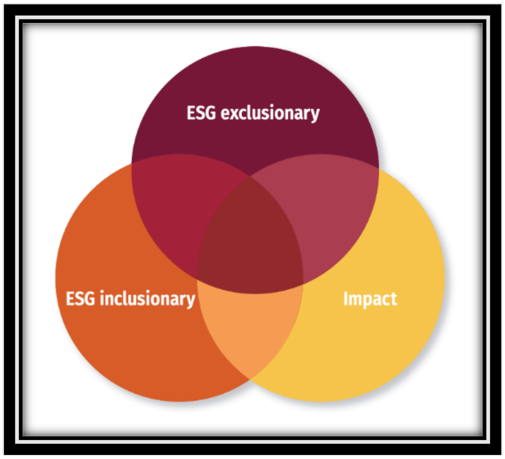
While fund managers consider ESG factors to varying degrees, there are three commonly used approaches: exclusionary investing, inclusionary investing, and impact investing. As Figure 2 illustrates, these approaches are non-exclusive, meaning that some funds may incorporate one or more sustainable investing strategies.

ESG exclusionary investing involves funds that exclude certain sectors or companies that do not meet the established sustainability criteria or investor preferences. For example, a fund manager would exclude companies from certain industries like tobacco, oil, and gas or have a bad record on issues like human rights and employee diversity. However, effective disclosure still needs to be established to inform investors on what they are buying and investors need to be better educated that not all ESG products are the same. This is especially the case when investors assume all ESG funds will exclude certain types of industries (e.g., fossil fuels) when that may not be the case at all.

ESG inclusionary investing involves funds that invest in companies that have strong records in environmental, social, or governmental areas. For example, the fund may only invest in companies that contribute to and benefit from carbon reduction, clean energy, or sustainable agriculture. Investors following this approach often claim that actively seeking companies that exceed their expectations is better than excluding those that do not meet their criteria. As a result, the use of third-party rating agencies to evaluate a company's business practices has become common practice under this approach.

Impact investing involves funds that seek to develop and reportable ESG impacts. Rather than excluding companies with poor ESG records, or only including companies with good ESG scores, impact investing seeks to produce a measurable positive ESG impact in addition to a substantial financial return. Rather than seeking companies that align with investor preferences, this investment style aims to fund performance changes within all companies that have the potential to be sustainable. For example, the fund manager may view bonds that finance education, healthcare, or affordable housing as promoting positive benefits because they aim to create lasting sustainable changes. Furthermore, impact investing extends beyond public market securities and into direct investing through venture capital, growth equity and infrastructure.[14]

Figure 2: Integration of Multiple Approaches to ESG Investing



Source: Investment Company Institute.

Gen Z Expectations

Acknowledging Gen Z and Millennial investment demands is critical as these generations are assumed to be some of the largest future wealth holders. With millennials predicted to inherit a total of $68 trillion from Baby Boomers by the year 2030, the youth of today are expected to experience one of the greatest wealth transfers in modern times.[15] Young investors are increasingly seeking responsible investing options to improve sustainability outcomes across all industries. These investors want companies to prioritize the long-term economic well-being of firms, rather than just achieving short-term profit goals. Most importantly, younger generations are calling for firms to recognize their greater impact on society, to take responsibility for their actions, and to implement positive changes. Illustrated by the shift in focus from transparency to governance issues in ESG-related shareholder proposals,[16] it is clear that clients are increasingly focused on action over information. Politically active Millennials and Gen Zs are also holding those in power accountable to act on this matter by calling for legislatures to take a more bipartisan approach to standardizing ESG metrics.

Political Divide Over ESG Disclosures

With Republicans and Democrats more ideologically divided than they have been in the past two decades,[17] U.S. politicians are struggling to reach legislative agreement to develop ESG investment standards. Most importantly, politicians and government officials alike are debating whether ESG information can be constituted as financially material. Based on Thurgood Marshall's definition,[18] information is material if there is a substantial likelihood that a reasonable investor would consider it crucial in making investment decisions.

Over the past 50 years, the SEC has been reluctant to move forward with proposals to mandate ESG disclosure despite the persistent confusion over the topic. One SEC commissioner argued that standardizing ESG disclosures would conflict with the current disclosure framework "rooted in investor-oriented financial materiality,"[19] implying that standardizing ESG disclosures would not sufficiently accommodate across industry lines. Further, a Pennsylvanian Senator recently deemed "information about global warming, political spending, or any ESG-related topic" as financially irrelevant.[20] There is also a concern that the new disclosure requirements would disproportionately hurt smaller firms as producing ESG reports would require them to expend more resources than bigger companies.

In contrast, proponents of stricter disclosure mandates believe ESG information should be included in the definition of materiality because of the recent rapid increase in investor demand for sustainable investment options. Reports reflect a similar sentiment with a 30% increase from 2020 to 2021 in Environmental and Social shareholder proposals across all industries.[21]

Debate Over U.S. Regulation

While proponents of ESG call attention to the opportunities overlooked by not addressing long-term ESG-related risks,[22] professionals continue to debate the government's role in ESG financial regulation. An expert on energy and environmental policy recently argued in a Senate Committee hearing that Congress mandating financial institutions to evaluate climate risks would "distort the allocation of capital away from economic sectors."[23] Some are concerned about the "growing politicization of regulators" and the influence of interest groups on the financial regulators' decision-making process.[24] In fact, one central difference within most ESG legislation is the debate over the extent of political power given to regulators to address ESG issues and whether members of Congress are qualified to make these decisions in general.

Conversely, congressional advocates of the SEC regulating ESG disclosures argue that addressing ESG standardization has become a government responsibility as shareholders have continuously conveyed their demand for this information. Further, members of Congress in favor of regulation also claim that many ESG shareholder proposals leave "gaps" for corporations to fill on their own. Proponents ultimately agree that the majority of ESG legislation introduced is positive because it gives ESG disclosure the political recognition it needs to become standardized.[25]

Seeking long-term solutions within the SEC, according to Commissioner Hester Peirce and previous acting chair, Commissioner Allison Lee, continues to be one of the most prominent arguments surrounding ESG regulation. Commissioner Lee, advocating for the mandate of certain ESG disclosures, argues that the SEC has the responsibility to protect shareholders from forgoing the "benefits of comparability that would come with standardization."[26] Instead of focusing on the question of whether ESG information is relevant enough for the government to regulate, Lee asks "how" disclosures should be approached and based on which metrics. On the other hand, Commissioner Peirce warns that a standardized set of metrics could serve as an incentive for companies to adopt false environmental and social policies to obtain a higher ESG score among investors and gain an "illusory short-term reputational boost."[27] This concern highlights the significant threat of firms misleading investors with false ESG information reporting. The conversation surrounding ESG standardization within the SEC serves as hope for the development of ESG investing. Politicians on both ends of the political spectrum are beginning to recognize the importance of investor demand and shifting attention from materiality to standardization methods.[28]

Potential for Regulation

Agreement on the need for increased corporate diversity is one sign of bipartisan advances within ESG legislation. Most recently, Rep. Gregory Meeks (D-NY) successfully gained bipartisan support to pass the Improving Corporate Governance Through Diversity Act,[29] which will require public companies to annually publish the racial, ethnic, and gender composition of board directors and senior executive officers.[30] Conservatives have also begun to take initiative in developing sustainable policies. One example is the Republican-led Conservative Climate Caucus whose main objective is to "educate House Republicans on climate policies and legislation consistent with conservative values."[31] Further addressing the lack of policies aimed at ESG standardization, President Biden issued an Executive Order on Climate-Related Financial Risk on May 2021, which may move the U.S. considerably closer towards the creation of a mandatory ESG disclosure regime. The order aims to assist the federal government in combating the economic risks of climate change by reporting the financial impact of companies' environmental risks. More specifically, the order instructed Treasury Secretary Janet Yellen to work alongside the Financial Stability Oversight Council (FSOC) to adopt regulatory measures of climate change for financial regulatory agencies.[32]

Concern for Greenwashing

Given the rising interest in responsible investment by asset owners, both practitioners and regulators have raised concerns about greenwashing. The concept was developed by Jay Westerfeld in 1986 and can be defined as "the intersection of two firms' behaviors: poor environmental performance and positive communication about environmental performance."[33] To put it simply, fund managers may exaggerate their credentials or market funds as "ESG" branded to attract flows from responsible investors without ever incorporating ESG factors into their investment decisions. It is also not uncommon for funds made up by a small portion of ESG investments to be labeled as "green".

According to research by Quilter, greenwashing is the biggest concern (44%) for ESG investors.[34] Although greenwashing appears as a deliberate attempt by companies to attract investments, some greenwashing may be due to the current obstacles facing the standardization of ESG investing.

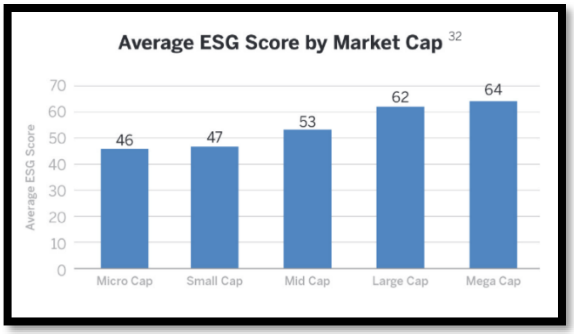
Frustration Over Opaque ESG Disclosure Standards

Due to the absence of mandatory ESG disclosure requirements, any implementation of an ESG disclosure framework by a U.S. company is currently voluntary. SEC Chairman Jay Clayton issued a statement in 2020 asserting the existing 2010 principles-based approach which only requires publicly listed companies to disclose any non-financial information that is material to the investor. He also underscored the threshold issues that created challenges for the creation of a standardized, disclosure-based regulatory regime, including the forward-looking nature of climate-related disclosures, complex and multinational landscape surrounding these issues, and the industry-specific differences between companies. Even though ESG disclosures remain voluntary, public companies are opting to incorporate them into sustainability reports or documents. As reported in 2021 by the State of GreenBiz in collaboration with S&P Global Trucost, 90% of the 500 biggest U.S. public companies published a sustainability report in 2019. This trend is expected to grow in the future, as evident from the 11% increase in the number of U.S. public companies producing a sustainability report between 2015 and 2019.[35]

The self-reported and voluntary nature of ESG data is a problem for investors to navigate. Self-reported sustainability reports tend to present corporations in their best light as part of a marketing initiative. Companies can use a globally accepted ESG standard such as the Global Reporting Initiative (GRI) or they can rely on their own criteria. Further, the absence of mandatory and standardized ESG disclosure regime means that not every company will report on ESG issues. Even if companies will report them, they won't do so in a consistent manner. Kotsantonis and Serafeim (2020), analyzing a random sample of 50 Fortune 500 companies, discovered that there are more than 20 different ways companies can report their Employee Health and Safety in the sustainability reports. This inconsistency creates difficulties for investors to compare different companies and determine the best performer in the same category.[36] Companies can also select whether to have their ESG reports audited by a third-party.

Without a uniform standard disclosure regime, there are also inherent biases stemming from variation in market capitalization size, location, industry, and sector. For example, as Figure 3 illustrates, companies with a higher market capitalization often receive higher ratings than smaller peers in the ESG space. As a result, risks specific to companies are not accurately captured in composite ratings. Unsurprisingly, a recent Deloitte study in 2016 revealed that over 80% of investors are disappointed with how risks and opportunities are quantified in financial terms. Disclosure requirements also vary significantly by geographic region and by country. EU law requires companies with more than 500 employees to disclose non-financial and other diversity information. On April 21, 2021, the EU adopted a proposal for the Corporate Sustainability Reporting Initiative Directive (CSRD) which would expand the scope of disclosure requirements to all large companies, require the assurance of reported information, and include more detailed reporting requirements.[37] North America does not have such requirements, which could be one reason for the positive bias towards European companies. A telling example would be Sustainalytics's ratings of BMW – manufactured in Germany – and Tesla, manufactured in the U.S. While BMW has a high rating (93rd percentile), despite controversies related to anti-competitive behavior and illegal marketing practices, Tesla's ESG score is lower than every European manufacturer. Meanwhile, Tesla is a world leader in technology to cut down on CO2 emissions.[38]

Figure 3: Average ESG Score by Market Cap

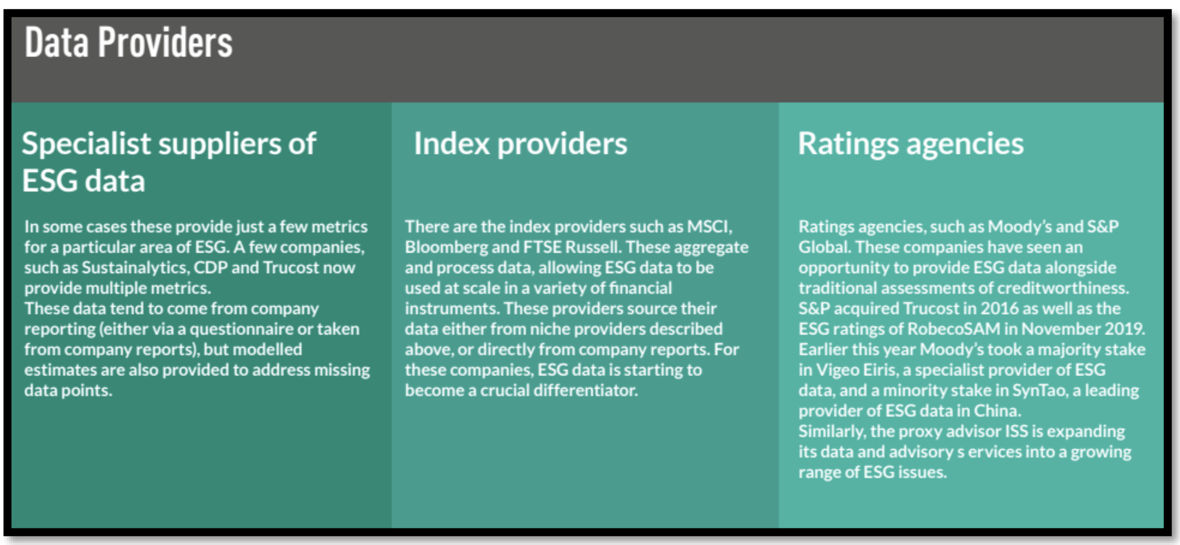


Source: American Council for Capital Information.

Filling the Void

Due to the absence of clear disclosure obligations in the US, third party data providers, many of whom provide a scorings and ratings system, play an important role in assessing the ESG credentials of a company. Some of the biggest players in the industry include MSCI, Refinitiv, ISS, Sustainalytics, and RepRisk. These companies are the gatekeepers to investment capital and provide asset managers and owners an alternative to conducting extensive investigation themselves. They take into consideration environmental (climate change, waste, greenhouse gas emissions, and pollution), social (working conditions, health, safety, and employee relations) and governance factors (fair tax, bribery, corruption, and board diversity) in their assessment of a company's ESG scores. The three main types of data providers are illustrated in Figure 4. Ratings agencies collect data from companies through questionnaires and public information and aggregate the information to provide a rating. MSCI and FTSE Russell are leaders in research-based indexes. The third category is specialized data providers focusing on a specific aspect of ESG.

Figure 4: Overview of Key Players



Source: Generation Foundation.

Status Quo: Measures and Metrics for ESG Funds

Scoring and index development are crucial for investors to align their investment strategies with ESG standards. Most of the rating agencies today are independent and have developed their own assessment tools. These rating agencies also prioritize different components of ESG performance to rate, which further distinguishes them from one another.

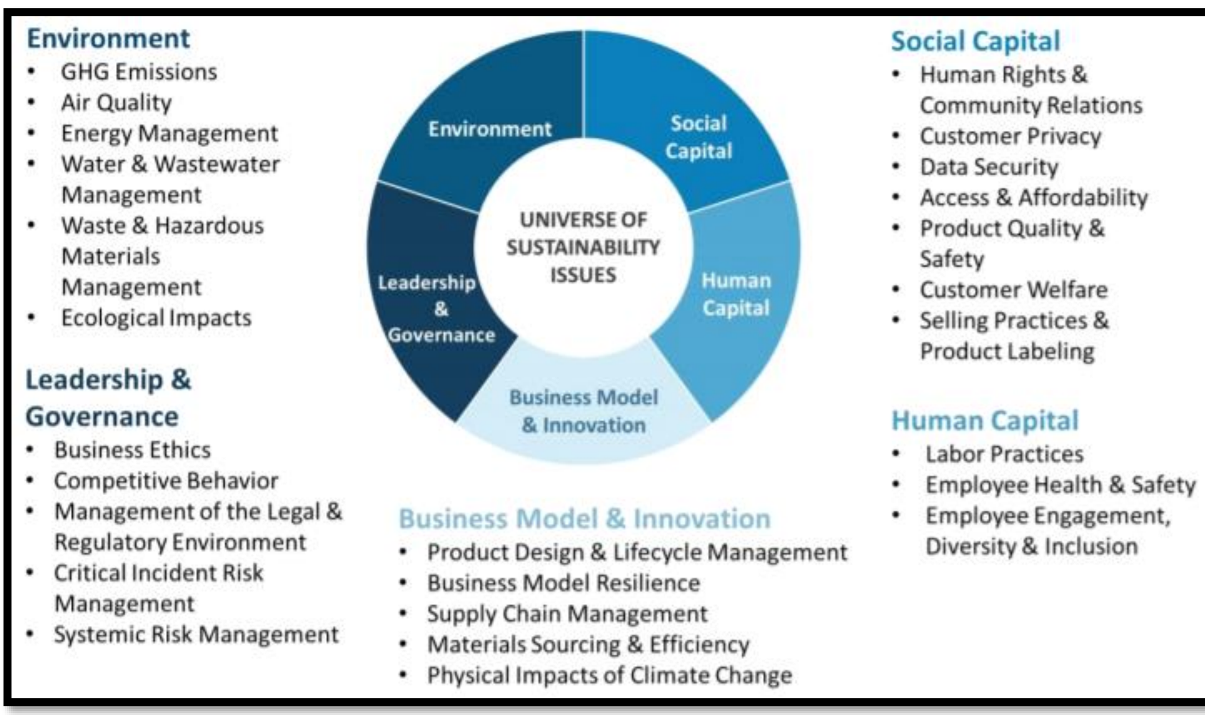
One common method is to evaluate ESG risk and opportunities as employed by MSCI and

Sustainalytics. Under this approach, companies evaluate key issues within each industry and company[39]. A rating agency can then choose specific issues to rate a company, contributing to the opaqueness of methodology. Each rater has a specific methodology and translates the results into their own rating scale. Other raters like Bloomberg assign rankings based on environmental impact. This leads to industries being divided into categories of low, medium, or high environmental and social impact.[40] Figure ~~4~~ 5 illustrates the variation in market coverage, rating scale, number of indicators and issues, and whether the data provider provides advisory services to companies between the most prominent ESG raters.

Figure 5: Comparison of Data Providers

Data Provider	# Of Firms	Rating Scale	Advisory Offered to Companies	Indicators (#)	Issues (#)
Bloomberg	>11,500	100-0	No	700	120
FTSE Russel	>4,000	5.0-1.0	No	350	125
MSCI	>2,800	AAA to CCC	Yes	1000	37
Thompson Reuters	>6,000	A+ to D-	No	400	178

Figure 6: SASB Materiality Map



Source: SASB website, provided for illustrative purposes.

Non-profit organizations, such as the Value Reporting Foundation (previously SASB), have created large-scoped reporting standards to initiate a form of standardization. The Value Reporting

Foundation mainly relies on existing metrics and prioritizes which factors and indicators should take precedence. Further, while explicitly connecting ESG indicators to financial materiality is still a challenge, the foundation translates their metrics into some type of financial performance. Generally, these indicators are linked to how they negatively or positively impact income and the cost of financing, which is the weighted average cost of capital.[41]

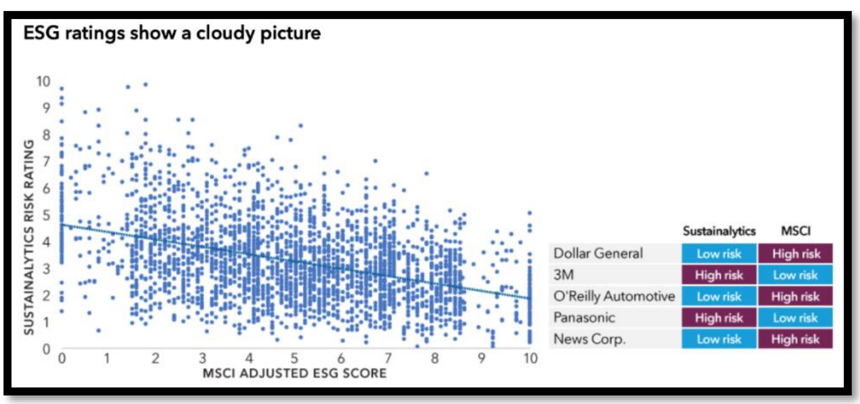
Although this step towards standardization has been taken in the U.S., criticism persists due to the lack of concrete tracking on the overall impact of a firm's actions because most metrics only focus on a few core issues but still lack a holistic breakdown.

Lack of Metrics for Measuring ESG Fund Effectiveness

Institutional investors often rely on public sources to locate important ESG data for their internal models. Sources such as government publications, reports from international organizations (including Eurostat, International Energy Agency, OECD, United Nations, World Bank), and non-governmental organizations are often utilized by fund managers to study ESG risks and opportunities. However, investors are not always able to collect and analyze the available data on their own. This is particularly the case for smaller organizations, who tend to work with external asset managers. Current models and metrics are not broadly accepted and investors may be reluctant to develop their own models due to the high costs and shortage of manpower. Hence, nearly 98% of investors use ESG ratings agencies to inform their investment decisions.[42]

Despite the proliferation of ESG rating providers, ESG ratings methodologies and data are not consistently comparable or easily verifiable due to the differences in methodology, scope, and coverage among these providers. While MSCI focuses on 37 key ESG issues divided into three categories and ten themes (climate change, pollution and waste, natural resources, human capital, etc.), RepRisk evaluates 28 ESG issues connected to Ten Principles of the UN Global Compact. There are also notable differences between providers in data acquisition and estimation methods. Providers may use statistical estimation models to fill in the gaps for unreported companies. This means that individual decisions made by the providers are factored into the data set (Bender and Maffin 2020). As a result, different data points may be reported across companies within the same industry. A study performed by MIT Sloan School of Management found a correlation of only 0.61 between major ESG rating agencies, whereas credit-rating agencies had a correlation of 0.92.[43] As illustrated in Figure 7 the ESG ratings produced by MSCI and Sustainalytics produce inconsistent ratings for various companies. Further, research independence may be questionable if the rating agency provides services to or develops partnerships with the company it rates.

Figure 7: Comparison of ESG Ratings by MSCI and Sustainalytics



Source: Capital Group, Morningstar, MSCI. As of December 31, 2020. Dots represent all companies in the MSCI ACWI index. Sustainalytics is a globally recognized leader in ESG ratings and research, and is wholly owned by Morningstar.

Third-party generated ESG scores, which provide a single metric to evaluate investments, have been criticized for their lack of transparency, among other reasons. Although these scores provide a more cost-efficient and useful way to compare between companies, major discrepancies exist between how platforms assign scores to each component (E, S, G), and how they weigh each score to assign a cumulative ranking. Further, ESG ranking methodology is usually criticized for its one-size-fits all approach. In fact, the relevance of ESG issues vary from industry to industry. A recent study by Russel Investments estimates that fewer than 25% of the data items used to calculate the scores of equities in the Russel Global Large Cap index are considered material according to SASB standards.[44]

Certain challenges may arise as disclosures become more standardized. Challenges will arise in standardizing the E component of ESG as the relevant data for each firm will depend on a variety of factors including industry, geographic location, and other factors. Companies will also have to look towards outside vendors to collect and calculate new data. In addition, discrepancies between ESG data providers tend to increase with more available information.[45] This result is evidence of the need for a "clearer understanding of what different ESG metrics might tell us and how they might best be institutionalized for assessing corporate performance." In other words, it is essential for ratings agencies to develop standards on the interpretation of given ESG metrics.

Fintechs Tackling ESG Investment

Increasing concerns for environmental, social, and governance (ESG) issues have led to many trends in technology and financial management. Within the digital context, Fintech is one of the most cutting-edge business models that has great potential to drive sustainable economic growth. Fintech can be understood as the use of latest technologies in the area of financial services. According to the New Energy Nexus's "Climate Fintech: Mapping an Emerging Ecosystem of Climate Capital Catalyst' report, 75% of climate fintech companies are in their early stage, having raised $10 million in corporate capital or less. With greater standardization of ESG disclosures and measures moving slowly, advanced data analytics can provide better solutions for integrating ESG data into investment decisions. Global consulting firm Deloitte expects the sharp growth of ESG-focused investments to be accompanied by a broader implementation of emerging technologies among asset managers, such as AI. TruValue Labs applies AI technology to track more than a million data points based on the SASB framework to help companies monitor ESG-related performance over time.[46] Clarity AI leverages big data and Machine learning to aggregate more than 50 sources of structured and unstructured data.

Rising demand for ESG funds from Millennials and Gen Zs has generated a spike in startup innovation in the customized ESG fund management and ESG data aggregation space. Investors can now add or remove specific companies through direct indexing, which strives to replicate a broad market index by purchasing the individual equities instead of using an ETF or mutual fund. For example, invest-tech firm Ethic Inc. has developed platforms for advisors to personalize portfolios according to clients' financial goals, values, and tax management preferences. Ethic Inc. has recently raised $29 million in Series B funding with support from Fidelity and has emerged as one of the largest providers of sustainable direct indexing strategies for wealth advisors.[47] Some of the biggest asset managers are taking notice and joining in the race on direct index based SMAs through blockbuster M&A deals. Last year Morgan Stanley Investment Management paid $7 billion to acquire Eaton Vance, which includes Parametric.[48] Blackrock acquired Aperio, a business that also specializes in customized index strategies in February for $1.05 billion.[49]

The most successful fintech startups highlighted here in the ESG space have the capacity to create customized rules-based (indexed) funds, aggregate data using AI and machine learning, extract meaningful sustainability insights from large volumes of unstructured data from online sources, and aggregate and monitor company ESG performance at the speech of real time events. Fintech-powered ESG screening and analysis solutions have the potential to address the inconsistencies arising from corporate self-reporting and backward-looking data. These types of solutions accompanied by technology will continue to grow and innovate to accommodate the rising demand of investors for better transparency and customization in wealth management.

Conclusion

ESG, already proven to be a driving investment strategy across global markets, will one day dominate the financial industry. ESG has become a widely recognized financial opportunity that will require significant attention from institutions in order to become truly standardized. Organizations across the financial industry are increasingly seeking to develop metrics that can provide accurate and material comparability information to enable investors to make ethical and financially sound decisions. With the data collection methodology advancements made by these groups, new challenges have arisen as ESG investing is a multivariable, complex strategy that has yet to be fully normalized in the U.S. As a result, greenwashing has presented itself as a major threat to investors and requires further attention from companies and financial institutions in order to ensure investor capital is sustainably utilized. Though political differences play some role in the delay of ESG standardization, it is evident that regulators are recognizing the demand of investors in these funds and are working to reach legislative agreement. However, institutions and political figures must address the current measurement inconsistencies of disclosure information in order to ensure that this method of investing grows in a way that is beneficial to all future and current investors.

Recommendations:

Our team provides the following key recommendations, critical to supporting and enhancing the development of ESG investing in the United States.

- *Development of a more consistent corporate disclosure standard between industry sectors and jurisdictions.*
- *Development of a bipartisan approach to the issue of ESG disclosure regulations.*
- *More accountability for ESG ratings providers, potentially including regulation.*
- *Harmonization between ESG standards and frameworks, such as Value Reporting Foundation, the **International Integrated Reporting Council (IIRC)**, **CDP**, the **Climate Disclosure Standards Board (CDSB)**, the **Global Reporting Initiative (GRI)**.*
- *Investment in innovation and technology that have the potential to enhance ESG finance capabilities as well as incorporation of advanced data analytics into ESG analysis.*
- *Collaboration between public and private sectors along with other stakeholders such as investors and companies on disclosure and reporting standards.*
- *Ratings agencies need to adjust their methodologies and metrics for the differences in company size, geographic location, and industry sector to reduce biases.*
- *More transparency from ratings agencies surrounding the interpretation of ESG indicators and the assessment process developed by them to assign scores to companies.*

Authors’ Note

ESG investing is omnipresent and rapidly evolving. As five members of Generation Z, we value the potential of ESG investing to create a net-positive impact on society and, more importantly, on the lives of real people. ESG investing also provides unique return streams for investors, as well as business opportunity for the industry. But, challenges to reliable ESG investing include ambiguity of investment purpose, as well as misinformation to investors (greenwashing) – both of which make the need for ESG standardization evident. The purpose of this paper is to express a perspective on the topic of greenwashing from the generation that will be most directly impacted by ESG investing. We were guided to a better understating of all views on this subject by the overwhelming support of Joanne Medero, former Managing Director, Global Public Policy Group at Blackrock and current Independent Trustee/Director for the Nuveen mutual funds, and Melissa Zhang, MBA/MPA (JFK Fellow), Class of 2022, Harvard Kennedy School.

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