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ESG Essentials—A Fresh Perspective

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Introduction:

The concept of responsible investing has a long history dating back to the 1960s. Before the term ESG—environmental, social, and governance—emerged, institutional investors considered it a social responsibility to divest from companies conducting business in areas like tobacco marketing or South Africa during apartheid to discourage the continuation of unethical practices. However, despite the practice of responsible investing spanning decades, the term ESG was not coined until 2004, when the United Nations Global Compact introduced the concept to argue against the belief that investments should be strictly for monetary gain. In the UN Global Compact's published report, "Who Cares Wins," ESG is defined as a way to account for risks that indirectly affect the market and encourages investors to take into consideration the practices of the companies they fund.[1]

As years passed, interest in ESG investing grew rapidly. Industry-leading companies began to focus on minimizing practices that contributed to climate change or policies that had negative social implications. Investors began to show their support for policies aimed at mitigating global warming by starting climate-change-focused funds dedicated to reducing further global warming, for example by, for example, investing in renewable/clean energy or the creation of electric vehicles. The emphasis on companies aligning with the moral values of their investors and consumers appeared to benefit fund performance. In fact, the number of open-end funds and exchange-traded funds (ETFs) with a climate-related strategy surged by 16% at the end of 2023, and assets now stand at a value of $540 billion.[2] These funds were the demand for ESG investments seemed unquestionable.

However, due to the Russian invasion of Ukraine in 2022, energy prices soared, and investors began to question the sentiment that ESG factors could guarantee a good financial return. According to a Morningstar report on investing during an era of climate change, "As of December 2023, Clean Energy/Tech funds accounted for almost $10.2 billion in assets, or 32% of the total, down from a record 78% of market share at the end of 2020."[2] This occurred in tandem with a growing politicization of environmental investing, with many institutional investors beginning to question the profitability of current companies that aim for net-zero carbon emissions and ESG guidelines. These concerns regarding ESG investing are reasonable. The current data on ESG is so vast and diverse that there is continuous debate on what companies truly qualify as highly rated on ESG. The lack of regulation of ESG terminology and disclosure also influences the amount of transparency a company communicates regarding its business practices.

Additionally, many now assert that ESG has developed into a score that companies strive to achieve for the sake of appearances, rather than a code of ethics they choose to abide by. To prevent such practices, a new practice of "energy transition" investing has emerged as an easier approach to responsible investing. The practice is set out in BlackRock chairman Larry Fink's 2024 annual letter to investors. He writes that in the current political climate, a shift away from ESG toward clean energy transition investing, where investments are directed toward clean energy products, may be a successful way to combat climate change. Transition investing may be more impactful because it rewards, through funding, evidence of direct change, rather than ESG ratings, thus ensuring an "energy pragmatism," where decarbonization and energy security are priorities.[3]

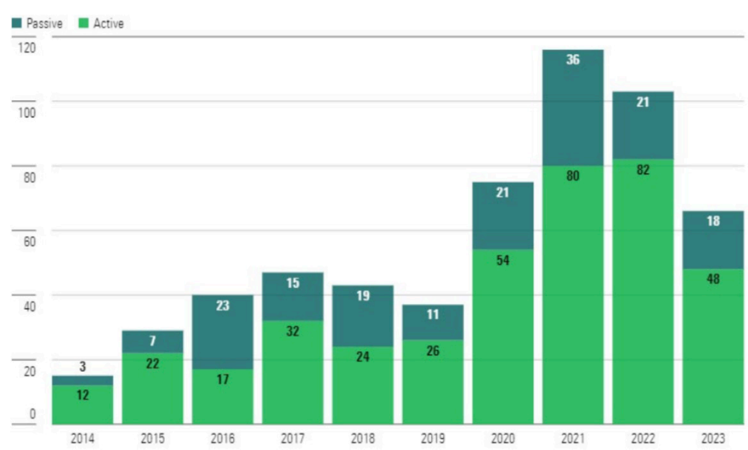
The lack of standardization of ESG definitions and the burgeoning questions surrounding the performance of ESG is the motivation behind this Opinion Snapshot. This paper discusses the basics of ESG, investigates its challenges in the current market, and encourages moderation of the current trend while emphasizing the need for investor choice where investors are free to choose what various companies and funds they choose to support in accordance with their own ethics of what is ESG.

Industry Trends

With several asset managers moving toward investing in energy transition, many companies will follow suit. The industry trend for energy has currently moved away from ESG due to its controversial nature and now focuses on transitioning to cleaner energy. However, companies are being increasingly pressured by environmental lobbyists and nonprofits to abandon practices that contribute to a warming climate. As a result, the importance of the "E" in ESG practices has shifted away from an optional factor to a required one. Several public companies have made it a mission to set substantial long-term sustainability goals to be included in their quarterly reporting. This means that regulatory bodies in the ESG sector should now hold companies accountable for these claims. Regulation can provide for more standardization in what information companies must disclose. However, a side effect of increased disclosures is an overwhelming amount of data that can further divide investors on what is truly "ESG."

The difficulty of standardizing ESG criteria has only been amplified in the recent political climate. Although reaching a new level of growth due to the COVID-19 pandemic, interest in ESG has since diminished. Despite the growing dollar value of ESG assets, demand globally slackened to open new ESG related funds. As Russia began to withhold gas from several countries and the economic repercussions of the pandemic finally began hitting consumers, the price for energy soared. As Exhibit 1 shows, sustainable fund launches began to decline after 2021, and ESG strategies had to change to keep up. The trends of green bonds and sustainable financing that emerged in the effort to support environmentally friendly projects have suddenly shifted to an energy transition strategy to keep up with the demand of investors. Responding to client demand, asset managers are increasingly approaching ESG with a more nuanced outlook, recognizing its flaws and contradictions as a practice.

Exhibit 1. Sustainable Fund Launches, Passive vs. Active



Source: Morningstar Direct. Data as of Dec. 31, 2023. Includes funds that have liquidated. Does not include original launches of funds that have subsequently repurposed.

From Trends to Investment Products

As ESG practices continue to evolve, shifting from a primarily green focus to a more complex landscape of measuring carbon intensity and nuanced ethical considerations, it is essential to examine how different strategies are employed in response to these changes. This section will explore the three main climate-focused strategies available to investors, who now have multiple avenues for aligning their portfolios with their values while still seeking financial returns. These three prominent ESG strategies are exclusionary strategies, inclusionary strategies, and impact investing. Each approach offers distinct methods for addressing environmental concerns and managing climate risks, reflecting the growing sophistication and diverse landscape of sustainable investing.

Exclusionary strategies, also known as negative screening, involve avoiding investments in companies or sectors that do not meet certain ESG criteria. This approach typically targets industries that involve fossil fuels, deforestation, or fast fashion, which investors deem harmful to the environment. By excluding these companies, investors aim to reduce their exposure to ESG-related risks and avoid supporting practices they consider unethical. Most exclusionary strategies start with a broad market index, like the S&P 500 or the Russell 1000 Index, and remove stocks closely tied to certain lines of business. For example, the SPDR S&P 500 Fossil Fuel Reserves Free ETF (SPYX) aims to provide exposure to companies in the S&P 500 Index while excluding those involved in fossil fuel reserves.[4] It focuses on companies that do not hold fossil fuel reserves, aligning with an environmental exclusionary approach. Inclusionary strategies, or positive screening, actively seek out companies with strong ESG performance. This approach involves investing in businesses that lead in sustainability, environmental stewardship, and social responsibility. Inclusionary strategies aim to reward and encourage best practices in ESG, contributing to a more sustainable and ethical economy. For example, BlackRock's iShares Global Clean Energy ETF (ICLN) seeks to track the investment results of the S&P Global Clean Energy Index, which is composed of approximately 100 global companies in the clean energy sector.[5] By providing exposure to companies that produce energy from solar, wind, and other renewable sources, the iShares Global Clean Energy ETF helps investors access clean energy stocks around the world, promoting investment in sustainable energy solutions.[6]

Impact investing is an investment approach that seeks to generate positive and measurable environmental impacts alongside a financial return. Unlike traditional investing, which primarily focuses on financial returns, impact investing places equal emphasis on the intention to bring about measurable, beneficial outcomes for society or the environment. However, it is equally important to distinguish between impact investing and philanthropy. Whereas philanthropy involves promoting the welfare of others through donations and charitable causes, impact investments are still expected to generate a financial return on capital. Pertaining to individual and institutional investors, impact funds are a way to engage in an ESG-focused strategy. Impact funds typically invest in projects or companies that address specific challenges, such as climate change, renewable energy, or social equity. Impact funds go beyond traditional ESG criteria by focusing on investments that have a direct, positive impact on the world. For example, BlackRock offers its Global Impact Fund, which contributes to a range of environmental objectives such as alternative and renewable energy, energy efficiency, pollution prevention or mitigation, and reuse and recycling.[7] The fund invests at least 80% of its total assets in equity securities and equity-related securities of companies globally whose goods and services address environmental problems but also provide financial returns. "The impact investing industry continues to become more and more integrated into investment portfolios and mainstream finance as a way to meet the desires of investors to do good while doing well," says Laura Skiles, director of impact for community finance solutions with US Bancorp. "Impact investing data continues to show that investments focused on social and environmental issues provide strong and growing returns as well as measurable positive outcomes."[8]

In a US election year where environmental and social issues will play a prominent role in the presidential race, investors may aim to put their investment dollars into areas where they can affect those areas they feel strongly about.

Are Climate-Focused Funds Just "Good Risk Management" Rather Than Promoters of Sustainability?

Despite the growing popularity of climate-focused strategies, there are concerns that these investments are primarily about managing financial risks rather than about making a genuine commitment to sustainability. This perspective suggests that by avoiding climate-related risks, investors are simply protecting their portfolios from potential losses due to regulatory changes, physical impacts of climate change, or shifts in consumer preferences rather than committing to combatting climate change. While risk management is undoubtedly a component, the broader impact these investments have on promoting sustainable practices must not be overlooked. Many investors and companies realize that integrating ESG factors into their portfolios can lead to real-world risk reduction and long-term value creation.

The physical risks posed by climate change, such as extreme weather and rising sea levels, are a significant call to action for companies and investors. These risks can lead to substantial financial losses, since they disrupt supply chains and damage infrastructure. Consequently, companies increasingly recognize the necessity of adopting climate-resilient practices. Investors, too, are playing a crucial role in this shift, pushing companies to integrate sustainable strategies to protect their investments. This shift not only aims to mitigate immediate risks but also drives a long-term commitment to sustainability. By investing in climate adaptation and mitigation strategies, companies can reduce their vulnerability to climate impacts and contribute to a more sustainable future.

As a result, the risk of not being perceived as a "green company" has become increasingly significant. Take ExxonMobil, for example. As one of the world's largest oil and gas companies, ExxonMobil faces significant scrutiny of its environmental impact. In 2020, ExxonMobil was defeated by the activist hedge fund Engine No. 1, who successfully waged a battle to install three directors on the board of ExxonMobil with the goal of forcing the energy giant to take environmental and social performance as seriously as it took financial returns.[9] Engine No. 1 argued that ExxonMobil was stuck in the past, failing to position itself for a coming shift to clean energy, and addicted to big spending on oil and gas projects that no longer made financial sense. Additionally, Engine No. 1 called for ExxonMobil to develop a clear strategy for transitioning to a low-carbon economy, investing in renewable energy, and reducing its carbon footprint.[10]

Although ExxonMobil remains bullish on long-term oil demand, the founder of Engine No. 1, Chris James, says that he sees signs that the proxy fight set ExxonMobil on a new trajectory, pointing to several changes he says were pushed by the campaign.[10] Notably, the company brought outsiders into key senior roles, including leading the company's energy transition effort, marking a significant cultural shift for a company that traditionally promotes from within. More important, ExxonMobil has committed to investing billions of dollars into a new business line focused on what it calls low-carbon technologies, such as biofuels, carbon capture and storage, and low-emission hydrogen.[10]

While the market has generally trended upward with energy producers following suit, the benefit of Exxon's integration of ESG into both its short- and long-term initiatives cannot be ignored. This is reflected in ExxonMobil's stock price, which has increased approximately 266.7% from $32.51 on October 26th, 2020, to its current share price of $119.22 on August 15th, 2024.[11] Increasing shareholder value was the goal for many investors who supported Engine No. 1's campaign, reinforcing the notion that companies genuinely integrating ESG principles into their practices tend to mitigate risks and perform better in the long term.

Exhibit 2. Stock Performance of ExxonMobil Against Rivals Since Boardroom Defeat

Role of Manager Engagement/ Shareholder Votes ("Stewardship")

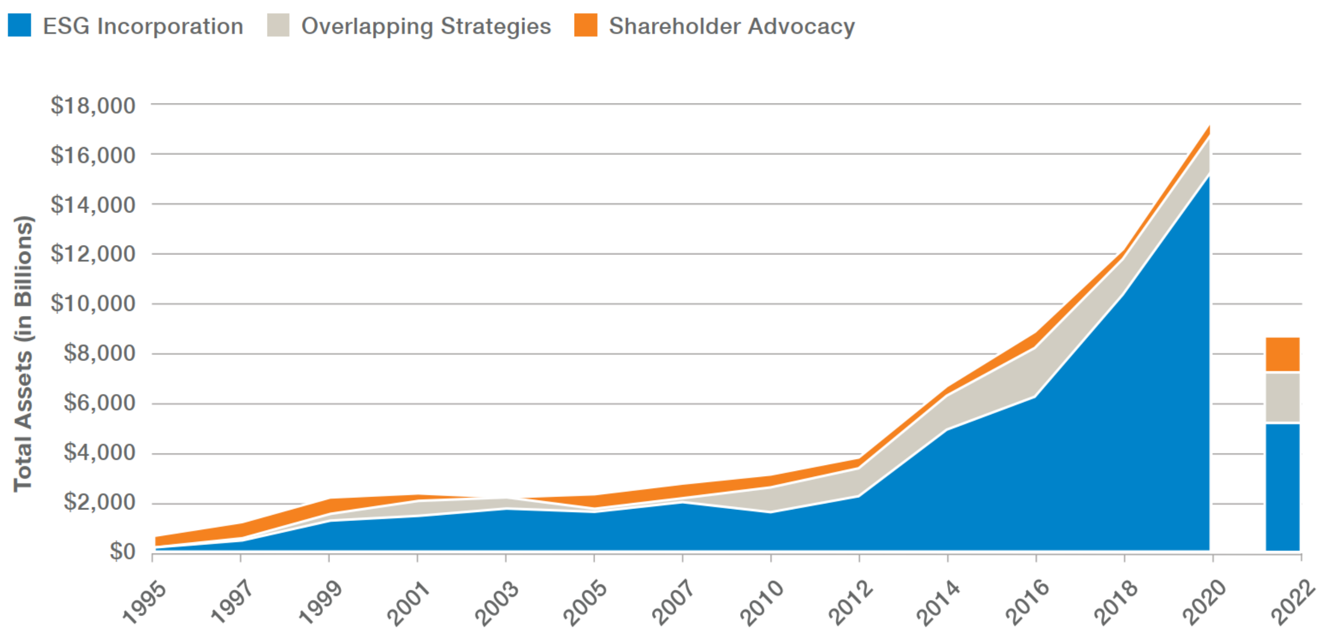
Beyond risk management, climate-focused funds also play a crucial role in promoting sustainable practices through manager engagement and shareholder votes, often called stewardship. Active stewardship involves fund managers engaging with companies to encourage better ESG practices and using shareholder influence to drive corporate behavior toward more sustainable outcomes. Through stewardship, investors can exert significant influence, ensuring that companies are not only aware of their ESG responsibilities but are also held accountable for their performance.

The Principles for Responsible Investment (PRI) defines stewardship as "the use of influence by institutional investors to maximize overall long-term value including the value of common economic, social and environmental assets, on which returns and clients' and beneficiaries' interests depend."[12]

Manager engagement and shareholder stewardship are considered potential solutions to concerns that sustainable investments are primarily driven by risk management practices rather than by genuine environmental concern. Effective stewardship focuses on enhancing the long-term value of investments by encouraging companies to integrate ESG factors into their strategies. This practice not only mitigates risks associated with climate change and regulatory shifts but also identifies opportunities for innovation and market leadership in sustainability.

Stewardship is where ESG insights are put into action. It entails direct engagement between investors and the companies they invest in, aiming to drive positive change and protect the long-

Exhibit 3. Sustainable Investing in the United States, 1995–2022



SOURCE: US SIF Foundation

term value of these companies. Regardless of the specific investment strategy, active engagement and collaboration with issuers on ESG matters enable investors to genuinely integrate sustainability into their strategies, going beyond what portfolio construction and management alone can achieve.[13]

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Data Challenges

All investment decisions rely on data, and in relation to ESG, access to the right data and providers is vital. It can be easy to get caught up in the jargon of what ESG might be, but it is imperative to focus on the original foundation of what ESG is meant to accomplish. Furthermore, due to vagueness in the definition of ESG, the different strategies investors use to achieve their goals could have unexpected or unplanned-for results. The availability of reliable data—or lack of it—presents challenges. One of the main data challenges is not necessarily a lack of data, but instead a lack of standardization. ESG-specific disclosures are not mandatory in public filings, leaving investors with an overwhelming amount of data and number of rating providers to choose from. Navigating which ones are most aligned with investor goals is an even deeper issue.

According to Sustainability News, the top six ESG rating providers are S&P Global ESG, MSCI ESG Research, Sustainalytics, JUST Capital, EcoVadis, and FTSE4GOOD.[14] These rating providers are leaders in commercial analytics, but all cater to different clientele. Rating providers such as S&P Global ESG, MSCI ESG Research, and FTSE4GOOD are geared toward institutional investors. Meanwhile, providers such as Sustainalytics, JUST Capital, and EcoVadis offer their services to institutional and retail investors.

Institutional investors benefit from easy access to multiple rating providers, given that they can absorb the costs, whereas retail investors are much more cost constrained. Nonetheless, investors across the board would all benefit from having an administered and regulated ESG rating provider. An example of the disparity between rating providers is evident when comparing MSCI and Sustainalytics. Both rating providers are listed as dominant resources: however, their methods of evaluating companies differ and can confuse investors due to different conclusions.

The variation in evaluating methods raises concerns and highlights the potential impact on investment decisions. MSCI gives a company a score like that of a credit bond rating, from AAA as the best score attainable ("leader") to CCC as the worst ("laggard"). Alternatively, Sustainalytics composes a score ranging from 0 to 100, with the higher the score, the greater the degree of risk concerning ESG considerations. A lower score means a company or firm faces lower risk in relation to its ESG efforts. A recent study cited by Bloomberg "found half of the 155 companies [analyzed] that got upgrades did so in significant part because of changes to the way MSCI calculated scores, not because of any changes in the companies' behavior."[15] Though a leader in the ESG sector, MSCI has not created rigorous enough standards that allow investors to get the full picture. Comparable to the issue of grade inflation, MSCI would be the one giving good grades where the bare minimum gets companies further than it should. In an interview at the COP26 Climate Change Summit in Glasgow, Scotland, the CEO and chairman of MSCI, Henry Fernandez went so far as to say, "many portfolio managers don't totally grasp that [either]. Remember they're fiduciaries . . . they're not as concerned about the risk of the world."[15] The different approaches and competition between data providers have led to stagnation in ESG regulation and the lack of a standardized rating approach. Since 2021, the Securities and Exchange Commission (SEC) has worked on further developing regulations for ESG disclosures, yet little progress has occurred. Sustainalytics has voiced its concerns for the lack of regulation, stating, "not all companies report their data to the same degree or use the same format and terminologies in doing so. Data gaps can [then] aggravate reporting challenges for financial institutions."[16] This lack of standardized disclosures contributes to the differences in ratings from all the rating providers.

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ESG data and ratings are frequently used to construct indexes that asset managers use for their products, such as mutual funds and ETFs. FTSE4GOOD and MSCI provide both commercial analytics and series of indexes. According to the ICI, indexes "offer a benchmark for evaluating the performance of actively managed funds, a template for constructing index funds, or even a tool for regulatory agencies." Additionally, they can be used for performance assessment, regulatory purposes, portfolio construction, management investment policies, and multi-asset portfolios.[17] They are tools meant to be used, as they can be helpful in many ways. In the ESG sector the main concern remains prevalent: there is no U.S. regulatory agency that overlooks ESG indexes and, as a result, an index labeled "ESG" often leads to different results than other indexes. An article by Fichtner, Jaspert, and Petry in Regulation & Governance explains the influence that rating providers have not only on investors but also on index funds. As stated, "essentially the index providers define the rules of the game," by defining and labelling which companies are sustainable and which are not. Furthermore, Fichtner, Jaspert, and Petry found that while there are a range of indexes offered to investors, they all measure and define sustainability differently.

Exhibit 4. Varieties of ESG Indices

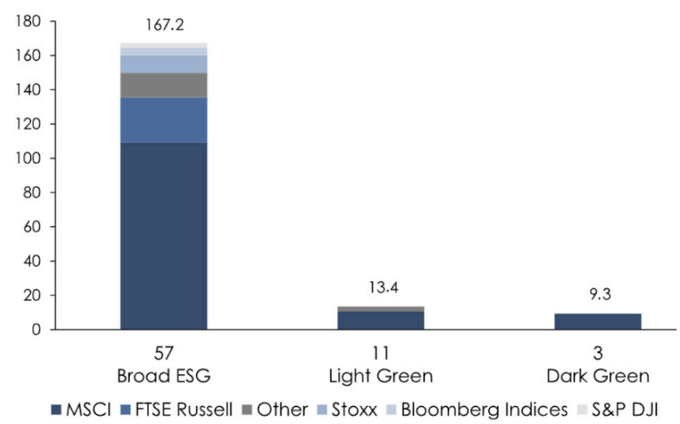
	MSCI	S&P DJI	FTSE Russell
Broad ESG	For example, Global Environment, Women's Leadership, Impact, ESG Screened ex Fossil Fuel, Faith Based, SRI, KLD400, ESG Leaders, ESG Focus, ESG Universal Index	For example, S&P ESG, ESG Select Equal Weight, Dow Jones Sustainability, DJSI Diversified, S&P Sustainability Screened, other Core ESG indices	For example, FTSE ESG Index Series, Blossom Japan, Green Revenues, Global Climate Index, Women on Boards Leaderships
Light Green	For example, Ex Fossil Fuel, Low Carbon Index	For example, S&P Global 1200 Fossil Fuel Free, Carbon Price Risk 2030 Adjusted Index	For example, Climate Balanced Factor Index, FTSE4Good RAFI, FTSE4Good Global Minimum Variance Index
Dark Green (Paris Aligned)	For example, Climate Change Index, MSCI Climate Paris Aligned Index	For example, Paris-Aligned & Climate Transition (PACT) Index	For example, FTSE Climate Transition Benchmark (CTB), FTSE Paris-aligned Benchmark (PAB) Indices

The authors provide a sample of ESG index funds, which they divide into three groups based off their investmentgoals and approach, the groups being broad ESG, light green, and dark green, as shown in Exhibit 4.[18]

It is riveting to see that among all three groups, only three funds fall under the dark green indices, whichare in line with the Paris Agreement's goals of reaching net-zero carbon emissions. Meanwhile, broadESG and the light green groups are more closely tied in definition, the difference being which scores orcompanies are included and how they are weighted. Broad ESG indexes are just that, broad. They havetoo many factors considered and as a result, have a small impact on sustainability. Light green indexes on the other hand, simply exclude a few companies based on ESG criteria, like that of an exclusionary strategy.

In the sample of funds alone, 57 funds worth \$167.2 billion and 11 worth \$13.4 billion fall into Fitchner, Jaspert, and Petry's broad ESG and light green indices, respectively. Consequently, the only three funds that fall under the dark green group are worth \$9.3 billion. The most important finding from all this is how "broad ESG indices are not likely to create sustainability impact via capital allocation . . . but are rather about safeguarding investment performance against adverse effects from climate change and state measures to mitigate it."[18] The ability for investors to have a choice is there, but the transparency for full-fledged strength in choice is a work in progress.

Exhibit 5. ESG Funds and AuM in Passive Segment by Index Type (US$ Billion)



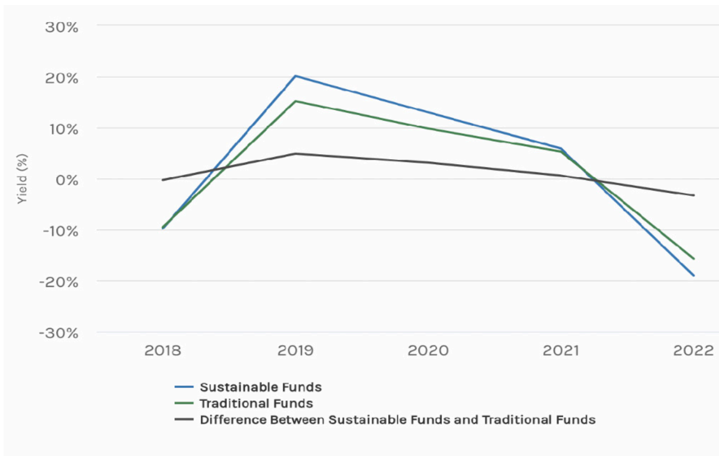
Around the globe, there is concern about regulation and disclosures regarding ESG. BlackRock's CEO, Larry Fink, expressed concerns about the lack of disclosure regulations in 2021 and 2024. In 2021, Fink urged companies to move quickly and "issue reports rather than waiting for regulators to impose them.[19] In addition, he believes that both public and private companies should adopt the Task Force on Climate-Related Financial Disclosures (TCFD) frameworks, which was created by the Financial Stability Board (FSB), to produce changes in accuracy of ESG disclosures. In the 2024 annual letter to CEOs, Fink mentions that internationally net-zero carbon emissions remains a top investment priority for most of BlackRock's clients, yet the SEC and the US have not acted.[3] Some causes of lack of progress on the climate change in the U.S. are the continuous political and economic turmoil and major shifts in policies between presidential administrations. As Michael Copley explains from NPR, ESG has become politicized as some Republican-led state officials believe "financial firms are abusing their power to advance a liberal agenda on issues like diversity, social justice, and especially climate change."[20] At the same time, Democrat-led states believe that financial firms are not doing enough, pushing for a more transparent market that includes legislative actions to require disclosure of social data as well as greenhouse gas emissions.[21] Amplifying the politicization of ESG, the U.S. Department of Labor (DOL) policies and practices vacillate as administrations change. Under the Trump Administration in 2020, the DOL issued regulations challenging ESG investing, but under the Biden Administration, the DOL revoked those regulations and proposed its opposite.[22]

While the back and forth continues in the United States, the European Union (EU) is years ahead with its guidelines on ESG. EU law requires "... all large companies and listed companies (except listed micro-enterprises) to disclose information on what they see as risks and opportunities arising from social and environmental issues, and on the impact of their activities on people and their environment.[23] There is a clear distinction between the EU's and the U.S.'s efforts in terms of ESG ratings and disclosures against ESG. In the US, the politicization of ESG further hinders ESG efforts and growth whereas the EU is benefitting from regulation. The political back and forth has led ESG to its current impasse, and it is important to return to its foundation and further allow investors to have the necessary transparency to make decisions.

Climate Change Products and Performance

The performance comparison between ESG investment products and their non-ESG counterparts is widely debated. Some studies show that ESG products can outperform non-ESG investments. Morningstar reported that 57% of ESG indexes outperformed their non-ESG equivalents in 2021, down from 75% in 2020. Over a five-year period ending in 2021, 80% of ESG indexes surpassed their non-ESG peers, indicating a strong medium-term performance trend.[24] However, more recent data reveals that many environmental funds underperformed in 2022 due to a challenging market environment, which included factors like rising interest rates and economic uncertainties. According to Morgan Stanley's analysis of Morningstar data, sustainable funds slightly underperformed behind traditional funds.[25] This variability underscores a core reason for the ongoing debate: the time period used for performance calculation.

Exhibit 6. Historical Return—Sustainable vs. Traditional Funds



Source: Morgan Stanley Institute for Sustainable Investing analysis of Morningstar data

Additionally, some studies suggest that ESG outperformance may stem from lower risk and volatility rather than higher returns. A University of Chicago study published in the Journal of Finance found no significant outperformance of ESG funds when adjusting for these factors.[26] This implies that while ESG investments may offer stability and reduced risk, they do not necessarily provide higher returns when these elements are considered. Disappointing performance in the most recent period may explain the current move away from ESG products.

The debate on ESG performance is further complicated by issues like greenwashing and greenhushing, which affect the credibility and transparency of ESG reporting. Greenwashing occurs when companies falsely market themselves or their products as environmentally friendly without substantial actions to support these claims. The 2015 Volkswagen scandal is a prime example of greenwashing's detrimental effects on a company's reputation and the broader ESG landscape.[27] Volkswagen used software to cheat emissions tests, misleadingly presenting its diesel cars as environmentally friendly. This led to severe consequences, including over $30 billion in fines, a loss of consumer trust, and increased regulatory scrutiny. The scandal highlights the financial risks of deceptive practices and the need for genuine ESG compliance, transparency, and accountability.[28] It underscores the importance of due diligence in assessing ESG claims to prevent investments based on misleading information and to ensure sustainability. By learning from this example, companies and investors can work toward a more sustainable and trustworthy ESG ecosystem.

> **"Greenwashing and greenhushing highlight the challenges investors face in accurately assessing companies' true sustainability, challenges that affect their investment decisions and the public's overall perception of ESG performance."**

Greenhushing, on the other hand, involves companies deliberately downplaying or underreporting their sustainability efforts to avoid scrutiny from investors and regulators. This can happen when companies fear their ESG claims might attract intense examination or believe their efforts do not meet stakeholders' high standards. For example, a company might engage in extensive sustainability practices but choose not to disclose them comprehensively, fearing that any perceived shortcomings could lead to negative publicity.[29] Greenwashing and greenhushing highlight the challenges investors face in accurately assessing companies' true sustainability, challenges that affect their investment decisions and the public's overall perception of ESG performance.

The best interest of investors regarding ESG investments often depends on their time horizon. Short-term investors may face challenges due to the potential underperformance of ESG investments during volatile market cycles.[30] These investors must weigh the possibility of lower short-term returns against the long-term benefits of ESG practices. On the other hand, long-term investors, such as those saving for retirement, insurance companies, and endowments, may find ESG investments more advantageous. These investments typically offer lower risk and volatility over time, leading to more stable returns and resilience during market downturns.[31] For instance, Vanguard, State Street Global Advisors, BlackRock, and other investment managers emphasize that integrating sustainability into investment strategies helps build more resilient portfolios and achieve better long-term, risk-adjusted returns. BlackRock's commitment to sustainability includes initiatives like measuring carbon intensity and developing technology tools like Aladdin Climate to help better manage climate-related risks and opportunities.[32] State Street Global Advisors also use an integrated approach, incorporating climate considerations into their capital market assumptions and portfolio designs. They emphasize the importance of engaging with companies to improve climate disclosures and risk management.[33] By focusing on sustainable investments, these managers believe they can help clients navigate the transition toward a net-zero economy, driving better financial outcomes over the long term.

Conclusion

In 2024, ESG investing officially reached 20 years of practice according to Morningstar, and with a strategy spanning decades, the blurring definition of ESG suggests the need to bring investors back to the very basics of its meaning. ESG is a concept meant to encourage investors to impose certain standards or societal expectations on companies' business practices and to make investment decisions based on companies' commitment to meeting those standards. In an age where information is widely accessible, the expectation for a company to abide by a moral framework of environmental, social, and governance practices is imperative to appeal to many investors and consumers. With the immense data challenges in ESG, and the difficulty in both regulation of data and the reliability of sources, the amount of information that industry or retail investors will consider depends heavily on their goal for their investment. As ESG ratings are currently unregulated, standardized ESG ratings are a necessity. However, as it stands today, there are no such regulations in the United States, in part due to political contentions. Additionally, due to lack of regulation of data, the perceived performance of ESG is skewed. Contradictory data on the performance of ESG in 2021 and recent underperformance may deter some investors from ESG investments. These past 20 years have proven that standardizing ESG will take time, and the current situation is not black and white. Whether an investor chooses an inclusionary strategy to invest in clean energy companies or an exclusionary strategy to rule out companies that do not adhere to a certain ethic, it is ultimately up to the investor to decide. Although there are many benefits to setting expectations for companies to abide by, the current lack of regulation means that standards will take time to fully develop. For that reason, this paper encourages moderation going forward regarding ESG. Moderation and an emphasis on investor choice may prove to be beneficial not only for investors but also for ESG investing itself in the long term.

Authors' Note

In completing our Opinion Snapshot, we sought to address the lack of standardization in ESG investing, stressing the importance of realigning it with its original purpose while also promoting greater investor choice. Our goal was to highlight how clearer frameworks can enhance transparency and drive more informed, impactful investment decisions.

We extend our heartfelt gratitude to Sapere Aude Consortium for providing us with the opportunity to engage in such meaningful research. This Opinion Snapshot is not only a testament to the dedication of our team but also to the invaluable guidance and mentorship we received from Bill Dunigan, Joanne Medero, and Lauren Goldfarb, whose insights were instrumental in shaping our work.

Endnotes

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