Supporting ESG Research Questions: The Current ESG Data Climate

Beyond the Numbers 2022
Michael Deike
Business Librarian
University of Notre Dame
What is ESG?

• Environmental, Social, Governance
• Scoring system to evaluate companies by these three dimensions
Origins

- Principally rooted in activist socially responsible investing from the 1960s
- Interest in accountability measures for companies polluting environment or otherwise committing immoral actions
Major Players in ESG Scoring

- Refinitiv ESG Scores (Thomson Reuters)
- Bloomberg ESG Disclosure Scores
- ISS Ratings and Rankings
- MSCI ESG Ratings
- S&P Global ESG Score
- Sustainalytics ESG Risk Ratings
- CDP Climate, Water and Forest Scores
- There are more
Why the sudden interest?

- May 2021: White House
  - Executive Order on Climate-Related Financial Risk
- October 2021: Department of Labor
  - Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights
  - Tie breaker provision
  - “a fiduciary may consider any factor material to the risk-return analysis, including climate change and other ESG factors. “
- General interest in topics relating to climate change and ethical investing
Research Assistance with ESG Data

• Major draw for Business and Economics researchers
  • Interesting attempt to apply investing ethics by a quantitative measurement
  • New methodology for evaluating company performance outside of the traditional fiduciary

• Example questions:
  • Do highly ESG rated companies perform better or worse financially?
  • Do legal actions against companies regarding ESG issues result in ESG score shifts?
  • Do ESG scoring providers offer consistent, accurate, or otherwise credible data?
ESG Research Issues

• Common struggles
  • Prohibitive costs of ESG data providers for historical analysis
  • Lack of details regarding ESG methodologies by providers
    • Struggles with provider support to clarify methodology questions
  • Lack of reproducibility of past research
  • Apparent lack of data gathering and reporting standards
General ESG Criticisms

- Alleged political bias of ESG rating systems
- Inequity in small vs. large business
- Inconsistency and lack of apparent trust with ESG provider decision making
Political Bias

- **Texas bans local, state government entities from doing business with firms that “boycott fossil” fuels.** Texas Tribune, August 24, 2022.
  - “The environmental, social and corporate governance (ESG) movement has produced an opaque and perverse system in which some financial companies no longer make decisions in the best interest of their shareholders or their clients, but instead use their financial clout to push a social and political agenda shrouded in secrecy,”

- **Utah Congressional Letter against S&P Global ESG Credit Indicators.** April 21, 2022.
  - “S&P gave Russian-controlled energy producers higher ESG ratings than similar entities in the U.S. Russian energy giants Gazprom and Rosneft outscored American energy companies ExxonMobil and Chevron.”
  - During this dispute, S&P removed Russia scores from view on their platform
Political Bias Cont.

- February 2022: EU Debate to reclassify weapons as a social ESG asset
  - “With a Russian invasion right on its doorstep, Europe now finds itself discussing whether weapons should be listed as ESG assets, to grant them more favorable access to financing.”
- March 2022: Sweden’s SEB Changes Course on Defense Stocks as War Tests ESG Rules
  - Raises question of applying a static rating system directly tied to political and moral positions which are historically dynamic
Inequity

- Measures favored by ESG ratings require large amounts of investment to achieve
  - Favors larger corporations with greater access to capital over small business
- Intrinsically elevates some industries over others
  - Fossil fuels
  - “Vice” industries
  - Firearms
Inconsistency and Trust

- Scores are not the same across rating systems
  - Companies treated with inconsistent degrees of harshness
    - E.g. Tesla removed from ESG Index
    - Follows Tesla consistently being rated below companies such as Exxon
  - Reputation of ESG rating providers not always having the best historical track record
Bibliography


A Bonus Story in ESG Headline Hindsight

- 2019 IFC Report: Sri Lanka Commitment to Sustainable Finance
- Mid to late 2021 EY Report: Sri Lanka’s commitment to taking up ESG issues as a top priority in pursuit of carbon neutrality by 2050.
- March 2022 Foreign Policy Article: In Sri Lanka, Organic Farming Went Catastrophically Wrong
- June 2022 AP and Washington Post: Sri Lanka’s economy has ‘completely collapsed,’ prime minister says.
- July 2022 Forbes: Rising Social Unrest over Energy, Food Shortages Threatens Global Stability
  - Protesters storm Sri Lankan president’s home and force resignation
  - “Somewhat ironically, an analysis of the full ESG rankings linked above shows that many of the nations with the highest scores are developing nations with the highest degrees of famine risk.”