LUISS Guido Carli
LIBERA UNIVERSITA' INTERNAZIONALE DEGLI STUDI SOCIALI

Department of Business and Management

Master's Degree Thesis in Corporate Finance
Chair of Cases in Business Law

"MAKING SUSTAINABILITY PROFITABLE: PATHWAYS TOWARDS POSITIVE CORPORATE IMPACTS AROUND ESG INITIATIVES"

Supervisor:
Prof. **Riccardo La Cognata**

Candidate:
Tommaso Sargentini
Id Number: 744001

Co-Supervisor:
Prof. **Andrea Sacco Ginevri**

Academic Year 2022/2023

INDEX

INTRODUCTION 5

CHAPTER 1 9

THE ENVIRONMENTAL ISSUE: INCREASING CRUCIALITY OF SOCIAL CONSCIOUSNESS OF A BUSINESS 9

1.1 - Earth's alarm: the climate change effects and future scenario 9

1.2 - Sustainable development evolution until the United Nations 2030 Agenda 11

1.3 - European Green Deal 13

1.4 - Sustainable Finance Action Plan 14

1.5 - What is CSR: history and theories 19

1.6 - Link between firm value and CSR: is CSR value-enhancing? 21

1.7 - CSR and ESG: differences and connections 25

CHAPTER 2 28

SUSTAINABLE INVESTING AND ESG TRENDS 28

2.1 - Sustainable and Responsible Investments: differences between ethical investing and impact investing 28

2.2 - From risk to opportunity: run to a sustainable finance 31

2.3 - Greenwashing? Explicit sustainability mandates 33

2.4 - Evolving trend of ESG investing: a look at BlackRock and Norway's sovereign wealth fund communication development 36

2.5 - The increasing importance of "S" factor 40

2.6 - ESG investing approaches and strategies 42

2.7 - ESG and financial performance: the impact on M&A activity 45

2.8 - The growth in responsible investments regulation and policy in Europe 49

CHAPTER 3 54

TOWARDS EFFECTIVE ESG LAW AND REGULATION: PATHWAYS FOR BROADER APPROACHES AND LONG-TERM SOLUTIONS 54

3.1 - The "Brussel Effect" and the need for standardize regulations 54

3.2 - A modern interpretation of fiduciary duties 59

3.3 - Fiduciary duty and human rights: balancing autonomy and obligations 64

3.4 - ESG rating: a system that is poorly shared and transparent 65

3.5 - ESG on trial: the disconnect between ESG scores and socially responsible behaviour and low level of protection from the current crisis 69

3.6 - How should companies adjust 73

3.7 - The Green Financing 76

CONCLUSIONS 81

BIBLIOGRAPHY & WEBLIOGRAPHY 86
SUMMARY 94

INTRODUCTION

Climate change and environmental concerns have increasingly become central issues for policymakers, companies, and public opinion over the past two decades. As a response, efforts to curb climate change and its impacts have become more urgent, and requests for transparency and in-depth data regarding environmental risks, as well as audits to enhance reliability, have been demanded from companies worldwide[1]. Lawmakers are also intensifying their efforts by issuing legislation aimed at tackling climate change. The European Union, for example, has put forward a set of standards to regulate ESG (Environmental, Social, and Governance) matters, including regulations around disclosure for companies, taxonomy for the asset management sector, and due diligence requirements[2].

It has become essential to develop financial models that incorporate environmental and social sustainability, as finance is a key lever to influence sustainable outcomes. Financing sustainable businesses has both strong financial and broader societal benefits, which is why sustainable finance continues to gain traction[3].

The shift towards sustainable models is driven by a diverse range of stakeholders, including governments, regulators, banks, investors, consumers, and employees. Governments are playing a crucial role by incorporating sustainability into their relief and growth agendas[4]. Regulators are actively driving structural changes to promote sustainability. Banks have also intensified their efforts, committing over USD 2 trillion to sustainable financing in 2021[5]. Investors are leading the way in innovative funding approaches to support the transformation. Consumers are increasingly demanding sustainable goods and services. Additionally, employees are advocating for fair

---

[1] Dienes C. (2015), "Actions and intentions to pay for climate change mitigation: Environmental concern and the role of economic factors", in Ecological Economics, Vol. 109 (pp. 122-129)

[2] Chiu I.H.Y. (2022), "The EU Sustainable Finance Agenda: Developing Governance for Double Materiality in Sustainability Metrics", in European Business Organization Law Review, Vol. 23 (pp. 87–123)

[3] Ryszawska B. (2016), "Sustainability transition needs sustainable finance", in Copernican Journal of Finance & Accounting, Vol. 5(1), (pp. 185-194)

[4] Wilkinson A., Hill M., Gollan P. (2001), "The sustainability debate", in International Journal of Operations & Production Management, Vol. 21(12) (pp. 1492-1502)

[5] Available from: https://www.unepfi.org/banking/more-about-the-principles/progress/prb-collective-progress-report-2021/ (accessed on 20 May 2023)

treatment and equity in the workplace[6]. The convergence of these stakeholders underscores the urgency for businesses to adapt and respond to this evolving landscape of sustainability.

The concept of the circular economy (CE) has emerged as a major interest for companies, promising new business opportunities and a decrease in environmental impacts[7]. Corporate actions in this area are often referred to as Environmental, Social and Governance (ESG) or Corporate Social Responsibility (CSR).

Currently, investors perceive ESG practices as a means to capture value, rather than a risk, thereby considering it as an opportunity to drive profitability. There is a growing perception that incorporating ESG criteria in corporate strategy is closely intertwined with business resilience, competitive advantage, and financial performance[8].

With the growing importance of ESG among investors, activist shareholders now have access to a fresh set of powerful themes from ESG's range of concepts and standards that they can utilize in their efforts to influence the control and direction of companies through campaigns[9].

The belief in the capacity of ESG to create shareholder value and sustainability in companies and markets has been affirmed by the world's leading institutional investors and pension funds. Their endorsement has bolstered the credibility and authenticity of ESG operating principles and investments[10].

Given the enormous significance of the ESG agenda today, there are crucial facets that require thorough scrutiny, primarily related to the inherent weaknesses in the ESG rating system[11] and a regulatory framework that varies across the globe, potentially leading to conflicting priorities that represent a critical issue for the future growth and

[6] Lee M.T., Raschke R.L. (2020), “Innovative sustainability and stakeholders’ shared understanding: The secret sauce to performance with a purpose”, in Journal of Business Research, Vol. 108 (pp. 20-28)
[7] Morseletto P., (2020), “Targets for a circular economy”, in Resources, Conservation and Recycling, Vol. 153
[8] Baker M., Egan M.L., Sarkar S.K. (2022), “How Do Investors Value ESG?”, in National Bureau of Economic Research, No. w30708
[9] Liekefett K.H.E, Gregory H.J., Wood L. (2021) “Shareholder Activism and ESG: What Comes Next, and How to Prepare”, in Harvard Law School Forum of Corporate Governance, May
[10] Matos P. (2020), "ESG and responsible institutional investing around the world: A critical review"
[11] Walter I. (2020), "Sense and nonsense in ESG ratings", in Journal of Law, Finance and Accounting

impact of socially responsible investments (SRIs). Moreover, the recent crisis[12] have brought to light numerous inadequacies in the ESG domain.

The goal of this thesis is to provide readers with a comprehensive understanding of the challenges and opportunities in achieving effective ESG law and regulation, clarify the importance of ESG in investment decision-making with the necessity to integrate ESG factors within the framework of fiduciary duty, and shed light to the strategies that businesses can use to incorporate ESG initiatives and contribute to sustainable development while generating value.

Chapter 1 provides an overview of the environmental issues that have prompted the need for ESG integration, particularly the alarming consequences of climate change. This chapter also examines the evolution of the concept of sustainable development, the European Green Deal, and the Sustainable Finance Action Plan, which all aim to promote sustainable development through ESG considerations. Then delves into Corporate Social Responsibility (CSR), investigating the history and theories behind this self-regulating business model, and the link between firm value and CSR, trying to answer the question "is CSR value enhancing?". The chapter also explores the relationship between CSR and ESG with its difference and connections related also to elements of corporate governance.

Chapter 2 begins with an introduction to sustainable and responsible investing, exploring the differences between ethical investing and impact investing, discussing the goals and methods of each approach, and highlighting their key features. It examines the shift in perspective from viewing sustainability as a risk to viewing it as an opportunity, showing how sustainable finance is becoming increasingly popular as investors realize the potential for long-term returns by investing in companies that are sustainable. It gives real-life examples of how ESG investing is evolving and becoming more mainstream with a look at different approaches and strategies, also making an

[12] The term "recent crisis" in this context refers to two major events: the COVID-19 pandemic, which had a global impact on health, economies, and social structures, and the ongoing war in Ukraine, which has geopolitical implications: these crises have highlighted various shortcomings and challenges within the ESG domain, prompting increased scrutiny and the recognition of the need for robust ESG practices in navigating complex and volatile circumstances.

analysis of the ESG criteria that are influencing a growing number of M&A transactions. The chapter finally explores the different initiatives and frameworks that have been developed to encourage sustainable investing, particularly in Europe: it highlights the role of governments and policymakers in promoting sustainable investing and the potential impact of these initiatives on the industry.

Chapter 3 will delve into the various pathways that can lead to more comprehensive approaches and long-term solutions towards effective ESG law and regulation. The chapter aims to provide a detailed discussion of key topics related to ESG, including the need for standardized regulations to ensure a level playing field for all companies operating in different jurisdictions. Additionally, this chapter will delve into modern interpretations of fiduciary duties and how they can integrate ESG factors to protect the interests of investors while ensuring sustainable practices. We will also take a closer look at the delicate balance between autonomy and obligations when it comes to human rights, particularly in light of the growing importance of ESG considerations in investment decisions. Furthermore, we will examine the current ESG rating system and highlight its shortcomings, particularly in its failure to accurately reflect socially responsible behaviour. The chapter will also explore the potential impact of green financing as a key driver of sustainable investments.

CHAPTER 1

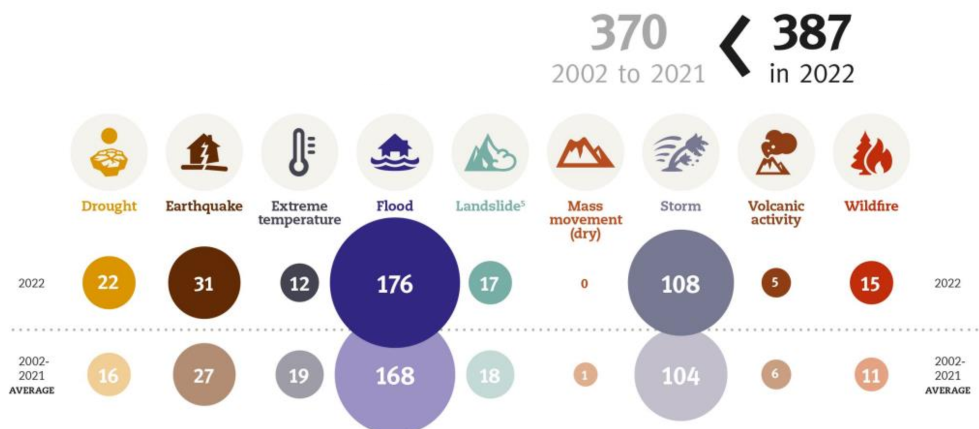
THE ENVIRONMENTAL ISSUE: INCREASING CRUCIALITY OF SOCIAL CONSCIOUSNESS OF A BUSINESS

1.1 - Earth's alarm: the climate change effects and future scenario

Climate change is defined as the shift in climate patterns mainly caused by greenhouse gas emissions, and global warming is mainly driven by the heat trapped in the earth's atmosphere due to greenhouse gas emissions[13]. The main sources of such emissions are both natural systems and human activities. Natural systems include forest fires, earthquakes, oceans, permafrost, wetlands, mud volcanoes and volcanoes[14], while human activities are predominantly related to energy production, industrial activities and those related to forestry, land use and land-use change[15].

The Centre for Research on the Epidemiology of Disasters (CRED) reported that the world encountered more than 380 cases of natural hazards and disasters in 2022, mainly climate-related, which is slightly higher than the average from 2002 to 2021 (370), resulting in economic losses of USD 223.8 billion.

Figure 1: Occurrence by disaster type: 2022 compared to the 2002-2021 annual average (CRED, 2023)[16]



---

[13] Fawzy S., Osman A.I., Doran J., Rooney D.W. (2020), "Strategies for mitigation of climate change: a review", in Environmental Chemistry Letters, Vol. 18, April (pp. 2069-2094)
[14] Yue X-L., Gao Q-X. (2018), "Contributions of natural systems and human activity to greenhouse gas emissions" in Advances in Climate Change Research, Vol. 9, Issue No. 4, December (pp 243-252)
[15] Edenhofer et al. (2014), "Technical Summary", in Climate Change 2014: Mitigation of Climate Change, contribution of Working Group III to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change, Cambridge University Press, Cambridge, United Kingdom and New York, NY, USA
[16] CRED (2023), "Disasters Year in Review 2022", in Cred Crunch, No. 70, April

A report by the United Nations Climate Change Secretariat (UNCCS) highlighted the severe impact of climate change on natural and human systems, including changes in climate indicators and associated vulnerabilities. In 2022, Europe experienced a minimum of five heat waves that broke previous records, where temperatures during summer soared to 47°C. Furthermore, climate risks including temperature shifts, changing seasonal patterns, precipitation variability, changes in disease distribution, ocean-related impacts and soil and coastal degradation, desertification, increase vulnerability across various sectors in many countries: food, water, health, ecosystems, human habitat, and infrastructure are the most vulnerable sectors hit by climate change[17].

The 15th edition of the World Economic Forum's (WEF) global risks report in 2020 highlighted various climate-related issues and their effects on different areas: these risks include loss of life due to health hazards and natural disasters, stress on aquatic/marine ecosystems, and food and water security. The report also predicts increased migration, geopolitical tensions and conflicts, negative financial impact on capital markets, and disruptions to trade and supply chains due to climate change[18].

The Intergovernmental Panel on Climate Change (IPCC) recently presented a report assessing the impacts and projected risks associated with global warming, warning that the world is set to reach the 1.5ºC level within the next two decades and increases beyond this point would amplify risk effects, concluding that we are currently in a state of climate emergency and only the most drastic cuts in carbon emissions from now would help prevent an environmental disaster[19].

[17] UNCCS (2019), "Climate action and support trends", based on national reports submitted to the UNFCCC secretariat under the current reporting framework

[18] WEF (2020), "The Global Risks Report 2020", in Insight Report, 15th Edition

[19] IPCC (2022), "Summary for Policymakers", in Climate Change 2022: Impacts, Adaptation and Vulnerability, contribution of Working Group II to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change, Cambridge University Press, Cambridge, UK and New York, NY, USA (pp. 3-33)

Considering the dramatic scenario that has emerged, companies must take proactive steps to promote sustainability in order to mitigate the negative impacts of climate change and be compliant with regulations related to environmental issues.

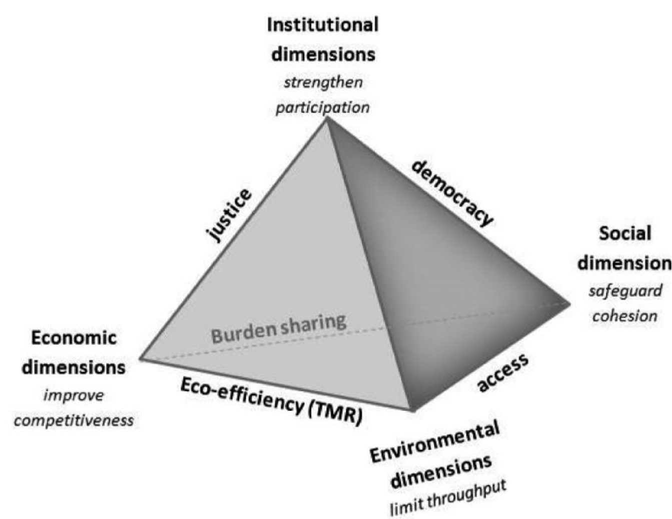
1.2 - Sustainable development evolution until the United Nations 2030 Agenda

The concept of sustainable development has been extensively explored in the current literature, with several notable milestones, beginning with the Brundtland report: the report, published in the book of "Our Common Future" in 1987 by the World Commission on Environment and Development, introduced the definition of sustainable development as "*development that meets the needs of the present without compromising the ability of future generations to meet their own needs*[20]."
After the release of the Brundtland report, many international institutions proposed similar definitions of sustainable development for the business community. In the book titled “Business Strategy for Sustainable Development: Leadership and Accountability for the 90s” (1992), it was recommended that businesses adopt strategies that fulfil the needs of the enterprise and its stakeholders while preserving, sustaining, and improving the human and natural resources required in the future. These strategies were primarily aimed to safeguard the natural environment to ensure future corporations having access to the same resources as current generations.[21] The business world has responded to such institutional challenges by introducing into strategic management certain strategies such as “clean production” and “eco-efficiency” approaches[22].
The United Nations World Summit on Sustainable development, which took place in Johannesburg in 2002, marked another milestone in the evolution of the sustainability concept. During this summit, the three dimensions of sustainability were emphasized:

[20] WCED (1987), “Report of the World commission on environment and development” by the Secretary-General, in Our common future, Brundtland report (pp. 1-91)
[21] International Institute for Sustainable Development (IISD), Deloitte&Touche, Business Council for Sustainable Development (BCSD) (1992), “Business strategy for sustainable development: Leadership and accountability for the 90s”, Vol. 3, Issue 3
[22] WBCSD (2000), “Eco-efficiency: creating more value with less impact”, in World Business Council for Sustainable Development, Conches-Geneva (pp. 32)

economy, environment, and society. This concept of the "triple bottom line" suggests that companies should strive to achieve improved financial performance, environmental protection objectives, and equity for societies simultaneously.[23] During the same period, Valentin and Spangenberg (2000) introduced another dimension named "institutional" into business strategy, which, along with the three other equally important dimensions, comprises the well-known Prism of Sustainability.

Figure 2: The sustainability Prism (Valentin and Spangenberg, 2000)[24]



More recently, in 2015, the first universal agreement addressing the issue of climate change, known as Paris Agreement, was signed by 196 countries. The 17 Sustainable Development Goals (SDGs) outlined in the United Nations' 2030 Agenda present new obstacles for companies which must prioritize sustainable strategies to align with the evolving concept of sustainable development, requiring them to modify their practices and plans to comply with the SDGs and promoting "*action over the next 15 years in areas of critical importance for humanity and the planet*[25]". These goals encompass a

[23] Tsalis T.A., Malamateniou K.E., Koulouriotis D., Nikolaou I.E. (2020), "New challenges for corporate sustainability reporting: United Nations' 2030 Agenda for sustainable development and the sustainable development goals", in Corporate Social Responsibility and Environmental Management, Vol. 27, Issue No. 4, August (pp 1617-1629)
[24] Valentin A., Spangenberg J.H. (2000), "A guide to community sustainability indicators" in Environmental Impact Assessment Review, Vol. 20, Issue 3 (pp. 381-392)
[25] United Nations (UN) (2015) "Transforming our world: The 2030 Agenda for sustainable development"

wide range of issues that are crucial for sustainability, including poverty, discrimination, climate change, environmental protection, education, and labour.

1.3 - European Green Deal

The European Green Deal (2019) published by the European Commission (EC), the policy-issuing body of the EU, comprises a set of policy initiatives on sustainable development and presents an opportunity for the EC to prioritize environmental protection and elucidate sustainable practices. It will require significant changes to the way that companies operate in their region.

It "*aims to transform the EU into a fair and prosperous society with [...] a competitive economy*". It is also a crucial part of the EU's plan to achieve the 2030 Agenda for Sustainable Development. Furthermore, it promises to protect citizens from environmental harms and impacts, and to be just and inclusive. Wellbeing is to be put at the centre of economic policy[26].

The primary objectives of the EGD aim to achieve a carbon-neutral European Union by 2050 and decouple economic growth from resource consumption. As a policy strategy, the EGD is not a law but a framework outlining ambitions and targets across various policy areas. To achieve these goals, current regulations and standards will be reviewed and revised, while new laws and directives will be formulated and put into action in the coming years. The mobilization of at least €1 trillion in sustainable investments is estimated to be necessary by the European Commission for the next decade. To achieve this goal, the EGD Investment Plan (EGDIP) is the primary approach, which will involve a combination of public and private funding, as the public sector alone cannot cover all essential investments. The EU Budget will provide €500 billion, while the InvestEU investment program will be responsible for mobilizing most of the remaining funds[27].

---

[26] Fetting C. (2020), "The European Green Deal", in ESDN Report, ESDN Office, Vienna, December
[27] Available from: https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_24 (accessed on 15 April 2023)

There are four key investment areas: Sustainable infrastructure; research, innovation and digitalisation; small and medium sized enterprises; social investment and skills.
The EGDIP allocates a minimum of 30 of investments to address climate-related issues across its four investment areas. The program comprises three pillars. Its first objective is to mobilize public and private funds for initiatives promoting the four main areas, using EU budget guarantees. The InvestEU Technical Advisory Hub provides advice to projects seeking funding, while the InvestEU Portal facilitates a platform where interested investors and projects can converge[28].
The European Green Deal is not a solitary strategy that offers a solution to the numerous environmental and climate-related issues facing Europe. Instead, it comprises a set of goals, aims, and targets that will be put into effect over the next decade. It establishes the fundamental framework for the required green transformation. However, reconciling different interests and achieving the overarching goal of contributing to the 2030 Agenda and the Paris Climate Agreement will be challenging. The ESDN Conference 2020 attendees recommended establishing a European sustainability narrative, promoting economic equity and representative democracy, and requiring political leadership to drive the transformation towards sustainability. Instead of recovery, the response should be a discovery process, expediting the transition towards sustainability.
In conclusion, the European Green Deal will require companies to take a more proactive approach to environmental sustainability. Those that fail to do so may face financial penalties or lose out on government contracts and incentives.

1.4 - Sustainable Finance Action Plan

On 7 March 2018, the European Commission released an action plan aimed at promoting financing sustainable growth. This plan includes a set of measures designed to channel private capital flows towards sustainable investments, as well as to integrate

[28] European Commission (2020), "The European Green Deal Investment Plan and Just Transition Mechanism explained"

sustainability considerations into financial decision-making. It is expected to have a significant impact on companies and their operations, as it will require them to align their business strategies with sustainability objectives and to disclose relevant information on their sustainability performance. The strategy was in response to suggestions made by the High-Level Expert Group (HLEG) on Sustainable Finance, delivered to the Commission on January 31, 2018.

The HLEG included nine PRI signatories. As an Observer, the PRI contributed technical knowledge to many of the proposals and issued an initial assessment of the 10 reform areas in the action plan.

The PRI, a UN-supported network of investors, is the world's leading proponent of responsible investment. Its objectives are to understand the investment implications of environmental, social and governance (ESG) factors and assist its global network of investor signatories in incorporating these factors into their ownership and investment decisions.

As institutional investors, they act in the long-term best interests of all parties involved, including its signatories, the financial markets and economies in which they operate, and eventually the environment and society at large.

The PRI is truly independent. It supports but is not a part of the United Nations and encourages investors to utilize responsible investment to increase returns and better manage risks without operating for its own financial gain. It interacts with global policymakers but is unaffiliated with any government.

In their capacity as fiduciaries, they believe that ESG issues have an impact on investment portfolio performance (depending on companies, sectors, regions, asset classes and through time).

An economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society. The PRI works to achieve this sustainable global financial system by encouraging the adoption of six Principles and collaboration on their implementation, fostering good governance, integrity and accountability, and

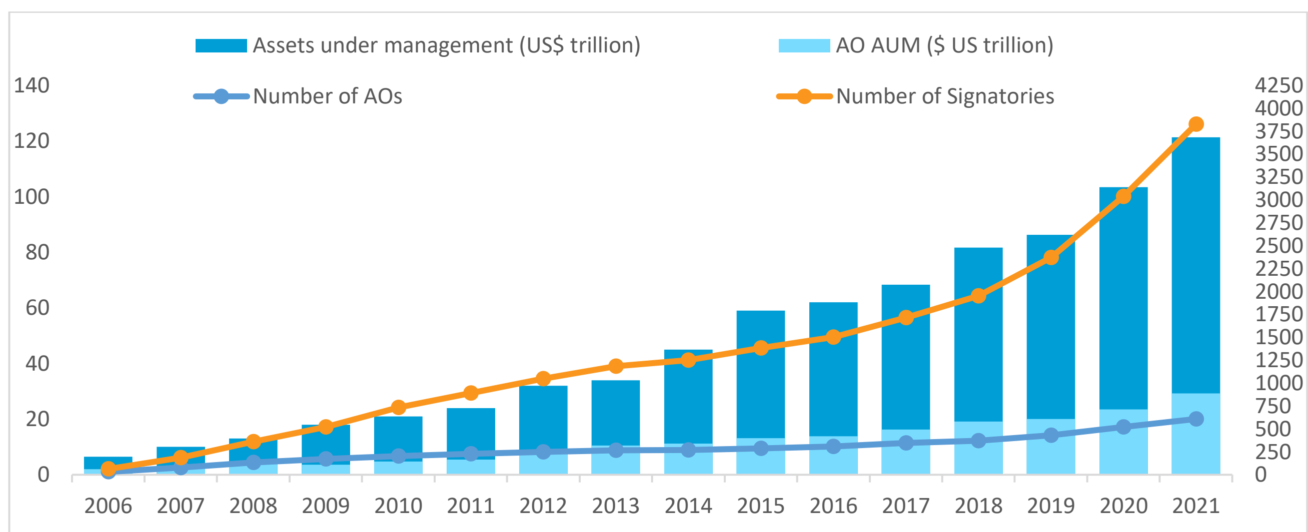
addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

Where consistent with their fiduciary responsibilities, these Principles consists in:

1) incorporating ESG issues into investment analysis and decision-making processes;
2) being active owners and incorporate ESG issues into their ownership policies and practices;
3) looking for appropriate disclosure on ESG issues by the entities in which they invest;
4) promoting acceptance and implementation of the Principles within the investment industry;
5) working together to enhance their effectiveness in implementing the Principles;
6) reporting on each of their activities and progress towards implementing the Principles.

The PRI has grown consistently since it began in 2006, reaching about 4,000 Signatories in 2021. Assets under management for these investors has increased from USD 6.5 trillion in 2006 to over USD 86 trillion in 2019.

Graph 1: PRI growth 2006-2021 (PRI, 2021)[29]



[29] Available from: https://www.unpri.org/about-us/about-the-pri (accessed on 15 April 2023)

Going back to the action plan, the ten reform areas outlined by the PRI are[30]:

1. establishing an EU classification system for sustainability activities;
2. creating standards and labels for green financial products;
3. fostering investment in sustainable projects;
4. incorporating sustainability when providing investment advice;
5. developing sustainability benchmarks;
6. better integrating sustainability in ratings and research;
7. clarifying institutional investors and asset managers' duties;
8. incorporating sustainability in prudential requirements;
9. strengthening sustainability disclosure and accounting rulemaking;
10. fostering sustainable corporate governance and attenuating short-termism in capital markets.

The Commission issued a set of regulations implementing numerous significant initiatives outlined in its action plan on sustainable finance in May 2018. The package includes:

- Taxonomy: the proposal suggests a regulation to establish a sustainable investment framework. It outlines the necessary conditions and framework for developing a standardized classification system, or taxonomy, for environmentally sustainable economic activities. This is considered a crucial initial step towards directing investments towards sustainable ventures.
- Disclosure and duties: the proposal aims to amend Directive (EU) 2016/2341(IORP 2 - Pensions) by introducing obligations on asset managers and institutional investors. These obligations will require them to disclose their approach towards incorporating ESG factors in risk processes. The proposed regulation will also specify the requirement to integrate ESG factors in the investment decision-making process as part of their responsibilities towards

[30] PRI (2018), "The European Commission Action Plan, financing sustainable growth: assessment of the reform; areas for PRI signatories", Version 2, July

investors and beneficiaries. Delegated acts will further outline these requirements.

- Benchmarks: a suggested modification to the benchmark regulation aims to establish a fresh classification of benchmarks that include benchmarks with low-carbon and positive carbon effects. The objective of this proposal is to assist investors in gaining a better comprehension of the carbon impact of their investments.
- Sustainability Preferences (consultation): the Commission has requested input on proposed modifications to delegated acts within the Markets in Financial Instruments Directive (MiFID II) and the Insurance Distribution Directive that would incorporate ESG considerations into the investment firms' and insurance distributors' advice to their clients.

One of the main effects of the Sustainable Finance Action Plan on companies is the need to demonstrate their sustainability credentials to investors and other stakeholders. Companies will need to show that they are committed to sustainable practices, and that they have a clear strategy for achieving sustainability goals. Another effect of the Sustainable Finance Action Plan is the potential increase in the cost of capital for companies that do not meet sustainability criteria. Investors are likely to demand higher returns for investments in companies that are not committed to sustainability, as these companies may face higher risks and lower long-term viability. This could lead to a situation where companies that do not align with sustainability objectives may struggle to access capital, which could limit their growth and competitiveness.

Overall, the Sustainable Finance Action Plan is a significant development for companies, and it will require them to adapt their business strategies and operations to meet sustainability objectives. Companies that are able to do so successfully are likely to benefit from increased access to capital, as well as enhanced reputation and stakeholder trust.

1.5 - What is CSR: history and theories

CSR has become an increasingly prominent topic in the business literature because of sharp increases in CSR investments, the publication of CSR reports, and in-depth research evaluations.

We do not have an ultimate definition of Corporate Social Responsibility (CSR), it is an area that is still under study and has gained significant knowledge over the years. This issue has recently garnered great interest and attention even if its history has distant roots.

In 1970, Milton Friedman famously argued that the only social responsibility of business was to maximize profits within the legal framework and the ethical custom of the country: these profits may be used for philanthropic causes if only they were returned to the company's owners, the shareholders, who should legitimately be represented by the management[31].

Since Friedman's warning about 50 years ago, business has developed in a very different direction from what he advocated. The pursuit of social good and financial benefit through socially responsible firms is widespread, giving the impression that business is about more than just making money.

Max B. E. Clarkson takes the opposite view to Friedman's: for him, the firm is a system of stakeholders operating within the larger system of the host society that provides the necessary legal and market infrastructure for the firm activities. The purpose of the firm is to create wealth or value for its stakeholders by converting their stakes into goods and services[32].

According to the Business Roundtable's (BRT) new stakeholder model of the revised purpose of the corporation, published in August 2019, businesses exist to serve a variety of stakeholders, including customers, employees, communities, the environment, and suppliers in addition to shareholders. 181 CEOs of significant firms

[31] Nilsson A., Sonanz GmbH, Robinson D., Duke University (2017), "What Is the Business of Business?" in Innovation Policy and the Economy, Vol. 18, edited by Josh Lerner and Scott Stern Duke I&E Research, No. 2017-12

[32] Clarkson M.B.E. (1995), "A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance", in The Academy of Management Review, Vol. 20, No. 1, January (pp. 92-117)

publicly endorsed this new paradigm. As organizations continue to or start to operationalize this stakeholder model into their long-term goals, it could have a significant impact on the designs of corporate incentives, metrics, and other governance areas. This is because incentive programs are essential to enforcing and communicating business strategy. While there are many different viewpoints regarding the BRT statement, the stakeholder model is becoming more significant and sophisticated[33].

The past and history are significant for CSR study and practice, according to an increasing body of research. However, the basic differences between the interpretations that academics and practitioners might attribute to the past and history pose difficulties for the integration of history and CSR thought[34].

The first definition of CSR was given by Archie B Carroll in 1979:

"The social responsibility of business encompasses the economic, legal, ethical, and discretionary expectations that society has of organizations at a given point in time[35]."

We can categorize the different responsibilities that society expects corporations to take on using this four-part framework. Each duty is only a small component of a company's overall social responsibility, allowing us to define what a company is expected to do by society. Thus, the four-part framework can be utilized to both clarify the motivations behind commercial decisions as well as to draw attention to the moral and arbitrary factors that managers occasionally overlook.

One of the most cited definitions of CSR is given by the World Business Council for Sustainable Development in 2000:

[33] Kay I., Brindisi C., Martin B., Pay Governance LLC (2020), "The Stakeholder Model and ESG", posted on Harvard Law School Forum on Corporate Governance, September

[34] Phillips R., Schrempf-Stirling J., Stutz C. (2019), "The Past, History, and Corporate Social Responsibility", in Journal of Business Ethics, No. 166 (pp. 203-213)

[35] Carrol A.B. (1979), "A Three-Dimensional Conceptual Model of Social Performance", in The Academy of Management Review, Vol. 4, No. 4, October (pp. 497-505)

"CSR is the continuing commitment by businesses to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families, local communities and society at large[36]*."*

Sacconi, in his definition of CSR, uses the concept of fiduciary duties:

"CSR is a model of corporate governance extending fiduciary duties from fulfilment of responsibilities towards the firm's owners to fulfilment of analogous fiduciary duties towards all the firm's stakeholders[37]*."*

In addition to these, we could cite so many other definitions that consider CSR as the responsibility of corporations to go above and beyond what the law requires them to do and to contribute a better society and cleaner environment; or how companies manage their business processes to produce an overall positive impact on society, something that done correctly should be about core business, not just add-on extras such as philanthropy.
A remarkable interdisciplinary integration of the past, history, and CSR thought has been achieved as a result of the combined efforts of organizational historians, academics of CSR, and corporate ethics.

1.6 - Link between firm value and CSR: is CSR value-enhancing?

The present value of a firm's past, present, and future performance is known as its firm value. The value of a company considers the long-term effects of managerial choices on the operating performances of the firm, including sales revenue, profits, cash flows, and growth potential. A company's value is positively impacted by improved performance and a variety of financial measures can be used to determine it, though

[36] Dahlsrud A. (2006), "How corporate social responsibility is defined: an analysis of 37 definitions", in Corporate Social Responsibility and Environmental Management, Vol. 15 (pp. 1-13)
[37] Sacconi L. (2012), "Corporate Social Responsibility and Corporate Governance", in EconomEtica, No. 38, June

they might not all yield the same result: the most common are the Economic Value Added, Return On Invested Capital, Return On Equity etc... They are strongly influenced by the market capitalization and financial markets. Increased operating performance and profit maximization are directly related to a company's value.

Companies can increase sales revenues, profitability, and consequently their value by providing distinctive products through the expansion of the existing markets, by cultivating a devoted customer base, or through other competitive advantages. A company may also acquire another company to gain synergistic advantages that raise the combined firm's value.

The value of a company also depends on its idiosyncratic risks. By lowering risks, businesses can increase their value, which lowers the cost of capital.

Despite the growth of the CSR disclosure literature, the measurement of CSR remains fragmented due to various viewpoints and methodologies. We can measure CSR considering the so-called Corporate Social Performance Model (CSP), but there isn't a way to calculate it in a quantitative way. According to Donna J. Wood, CSP refers to the principles, practices, and outcomes of businesses' relationships with people, organizations, institutions, communities, societies, and the earth, in terms of the deliberate actions of businesses toward these stakeholders as well as the unintended externalities of business activity[38].

There are some CSR indices: for example, the MSCI Kinder social index that is based on the exclusionary screens and strengths and weaknesses along the lines of a series of attributes. This index considers CSR starting from what is not socially responsible, excluding the so called "sin industries" that have significant involvement in alcohol, gambling, tobacco, firearms, and military weapons. Instead, the positive attributes for the CSR index are: community relations, support for education, social housing, diversity, policies in place to promote women and minorities, employee relations, relationships with trade unions, employee profit sharing schemes, policies aiming to reduce or prevent pollution, carbon neutrality, recycling, innovation, product safety,

[38] Available from: https://www.oxfordbibliographies.com (accessed on 20 April 2023)

policies enabling socially disadvantaged groups to benefit from the firm's products and services, etc.

Protecting the interests of various stakeholders has a variety of advantages, including those related to the product market (loyal customers, product diversification, expanded market share, and the development of brand equity), the capital market (increased market returns, lowered cost of capital, and decreased information asymmetry & risk), the employee (increased employee morale, job satisfaction, and employee productivity), the regulation (reduced litigation costs), and operational advantages (better managerial skills, improved operating effectiveness, improved corporate reputation and branding). All these advantages associated with high-quality CSR performance can enhance businesses' profitability and economic value over the short- and long-term[39].

According to one group of academics, CSR incurs additional costs that could put businesses at a financial disadvantage[40], and consequently that there is a negative association or no clear association at all between firm's financial performance and CSR. Another team of researchers has shown that these expenses are very insignificant in comparison to the potential benefits[41], and most of the research demonstrate that CSR and firm performance are positively associated.

Different CSR benefits may exist, and they may have an indirect or direct impact on a company's value.

Superior quality CSR initiatives carried out by firms can directly boost their value by ensuring:

- Capital market benefits such as increased market return, decreased cost of capital, improved risk management, and reduced information asymmetry: existing research asserts a strong positive correlation between CSR and stock

---

[39] Mlik M. (2015), "Value-Enhancing Capabilities of CSR: A Brief Review of Contemporary Literature", in Journal of Business & Ethics, No. 127 (pp. 419–438)

[40] Aupperle K.E., Carroll A.B., Hatfield J.D. (1985), "An empirical examination of the relationship between corporate social responsibility and profitability", in Academy of Management Journal, Vol. 28 (pp. 446-463)

[41] McWilliams A., Siegel D. (2000), "Corporate social responsibility and financial performance: Correlation or misspecification?" in Strategic Management Journal, Vol. 21 (pp. 603-609)

market performance, as measured by stock returns, market capitalization, and market to book[42].

- Product market benefits: according to some studies, CSR can help a company to expand its product market, differentiate from competitors increasing the competitive advantages, and establish a distinctive brand reputation.[43]
- Employment market benefits: CSR activities can improve employees' attitude[44], and increased employee job satisfaction and motivation lead to better operating performance which results in higher profitability[45].
- M&A Market benefits: in their study, Deng et al. looked into whether CSR adds value for shareholders of acquiring firms after a merger and they showed that during the post-merger period, high-CSR acquirers experience larger announcement returns and longer-term stock gains[46].
- Regulatory benefits: CSR also assists businesses to avoid exorbitant fines charged by the government. Better relationships with regulators have been proven to be promoted by CSR, especially in highly regulated industries[47]; according to research by Brown et al., companies who perform well in CSR are also more likely to be covered favourably by the media and by legislators[48].

The wide range of literature available provides compelling evidence that CSR initiatives can significantly increase a firm's value. These patterns suggest that managers are driven to pursue CSR activities because of their beneficial benefits on the company, as revealed by the rise in CSR investments.

[42] Caroline F. (2013), "Corporate social responsibility and shareholder reaction: The environmental awareness of investors", in Academy of Management Journal, Vol. 56 (pp 758-781)
[43] Singh J., Sanchez M.S., Bosque I.R. (2008), "Understanding corporate social responsibility and product perceptions in consumer markets: A cross-cultural evaluation", in Journal of Business Ethics, Vol. 80 (pp. 597-611)
[44] Solomon R.C., Hanson K.R. (1985), "It's good business", NewYork: Atheneum
[45] Banker R.D., Mashruwala R. (2007), "The moderating role of competition in the relationship between nonfinancial measures and future financial performance" in Contemporary Accounting Research, Vol. 24(3) (pp. 763-793)
[46] Deng X., Kang J., Low B.S. (2013), "Corporate social responsibility and stakeholder value maximization: Evidence from merger", in Journal of Financial Economics
[47] Freedman M., Stagliano A.J. (1991), "Differences in social-cost disclosures: A market test of investor reactions", in Accounting, Auditing and Accountability Journal, No. 4 (pp. 68-83)
[48] Brown W., Heiland E., Smith J. (2006), "Corporate philanthropic practices", in Journal of Corporate Finance, Vol. 12, No. 5 (pp. 855-877)

1.7 - CSR and ESG: differences and connections

Corporate Social Responsibility (CSR) and Environmental, Social and Governance (ESG) are two terms that are used when discussing how socially conscious a business is. As we have seen before, CSR is a self-regulating business model where companies are more conscious of the impact they are having on wider society; this includes the environment, the economy, and people within society. On the other hand, ESG criteria are a set of standards that potential investors use to screen companies that they could potentially invest in.

Both ESG and CSR are concerned with a company's impact on society and the environment, their main difference is that while CSR is a business model used by specific companies, ESG is a set of criteria that investors use to evaluate a company and decide whether it is worth investing in.

ESG includes governance explicitly while CSR includes governance issues indirectly as they relate to environmental and social considerations. Indeed, ESG tends to be a more expansive terminology than CSR[49].

Numerous connections between ESG/CSR activities and various aspects of the firm, such as the market in which the firm operates, firm structure (including leadership and ownership), and firm risk, have been hypothesized and documented by corporate finance researchers in theoretical and empirical work.

Evidence from Liang and Renneboog (2017) suggests that country characteristics may play a significant role in explaining the ESG/CSR activities of businesses and that legal origin is the best predictor of firms' adoption and performance of ESG/CSR, rather than political institutions, regulations, social preferences, and a firm's own financial and operational performance[50].

[49] Gillan S.L., Koch A., Starks L.T. (2021), "Firms and social responsibility: A review of ESG and CSR research in corporate finance", in Journal of Corporate Finance, Vol. 66, 101889

[50] Liang H., Renneboog L. (2017), "On the foundations of corporate social responsibility", in Journal of Finance, Vol. 72(2) (pp. 853-910)

Cai et al. (2016) provide evidence that economic development, law, and culture play a role in these differences and show how firms' ratings are significantly related to these factors.

Other studies have shown an association between CEO and board characteristics and a firm's ESG/CSR activities. Gender is one demographic factor that is frequently found to be important. According to Borghesi et al. (2014), American businesses with female executives or board members have significantly higher ESG/CSR scores[51].

Two other significant CEO attributes that have been documented as being linked to firms' ESG/CSR profiles are CEO age and CEO confidence. Borghesi et al. also draw the conclusion that CEOs who are younger are noticeably more likely to run companies with higher ESG/CSR scores.

Then, McCarthy et al. (2017) found a negative relationship between CEO confidence and firm ESG/CSR performance: they argue that this outcome can be attributed to the fact that hedging is a contributor to firms' ESG/CSR scores and that CEOs who are overconfident are less likely to hedge[52].

Considering the ownership, according to Boubakri et al. (2019), the privatized companies had overall higher ESG/CSR scores prior to their privatization. They also discovered that the political environment of the country and state ownership are influencing factors in this relationship[53].

It has been suggested that ESG/CSR may affect a wide range of risk types, including systematic risk, regulatory risk, supply chain risk, product and technology risk, litigation risk, reputational risk, and physical risk, through a variety of different channels[54]. For instance, a study notes how companies with stronger ESG/CSR profiles may be more resilient during times of crisis or may be more susceptible to certain

[51] Borghesi R., Houston J.F., Naranjo A. (2014), "Corporate socially responsible investments: CEO altruism, reputation, and shareholder interests", in Journal of Corporate Finance, Vol. 26, June (pp. 164-181)
[52] McCarthy S., Oliver B., Song S. (2017), "Corporate social responsibility and CEO confidence", in Journal of Banking & Finance, Vol. 75, February (pp. 280-291)
[53] Boubakri N., Guedhami O., Kwok C.Y., Wang H. (2019), "Is privatization a socially responsible reform?", in Journal of Corporate Finance, Vol. 56, June (pp. 129-151)
[54] Starks L.T. (2009), "EFA keynote speech: corporate governance and corporate social responsibility: what do investors care about? What should investors care about?", in Review of Finance, Vol. 44(4) (pp. 461-468)

ESG/CSR risk factors[55]. Related, there is evidence that firms with high ESG/CSR profile have a wider investor base and face lower litigation risk relative to irresponsible firms, ultimately leading to a lower cost of capital[56].

We have made note of the fact that some results are quite solid. Other findings, however, are contradictory, indicating that there is a need for research aimed at bridging the gaps in our knowledge and deepening our understanding of the issues.

[55] Benabou R., Tirole J. (2010), "Individual and corporate social responsibility", in Economica, Vol. 77, Issue 305, January (pp. 1-19)

[56] Hong H., Kacperczyk M. (2009), "The price of sin: The effects of social norms on markets", in Journal of Financial Economics, Vol. 93, Issue 1, July (pp. 15-36)

CHAPTER 2
SUSTAINABLE INVESTING AND ESG TRENDS

2.1- Sustainable and Responsible Investments: differences between ethical investing and impact investing

Various global indexes have been created to measure and report sustainability performance. Sustainability reporting involves measuring, disclosing, and being accountable to both internal and external stakeholders for organizational performance in pursuing sustainable development[57]. Integrated reporting goes beyond traditional financial reporting and encourages companies to combine their financial, economic, and social performance into one integrated balance sheet.

The SDG Compass was developed by the Global Reporting Initiative (GRI), the UN Global Compact, and the World Business Council for Sustainable Development (WBCSD) to assist businesses in comprehending and assessing their contributions to the SDG objectives. With over 1500 indices available to measure various aspects of sustainability, the SDG Compass aids businesses in understanding and measuring their impact on sustainability issues such as climate change, human rights, corruption, and others. GRI, an international independent organization, is dedicated to reporting on the impact of business on crucial sustainability issues. GRI Standards, which are established and endorsed by the Global Sustainability Standards Board (GSSB), are aligned with international declarations like the UN Guiding Principles on Business and Human Rights, the ILO Conventions, the UN Global Compact Ten Principles, and the OECD Guidelines for Multinational Enterprises[58]. According to GRI, 93% of the

[57] Heenetigala K., Lokuwaduge D.S.C., Armstrong A., Ediriweera A. (2016), "Investigation of criteria used for assurance practices of sustainability reporting in Australian listed companies", report presenting the results of research funded by the VU Central Research Grant Scheme in 2015 for Early Career researchers, Melbourne, Victoria University

[58] Armstrong A. (2020), "Ethics and ESG", in Australasian Accounting, Business and Finance Journal, Vol. 14(3) (pp. 6-17)

world's largest 250 corporations use GRI sustainability indices to report on their sustainability performance[59].

Many international investment associations define Sustainable and Responsible Investments (SRIs) as investments in business activities that have positive social and environmental impact[60]. One of the most well-known aspects of socially responsible investing is the evaluation of investments not only based on financial factors, but also on their environmental, social, and corporate governance practices, also known as ESG.

SRIs attract various types of investors who are motivated by different factors. For instance, environmental investors exhibit a heightened concern for environmental issues, social investors place greater emphasis on the social consequences of their investments, while sustainable investors prioritize the maximization of their contributions to sustainable development[61]. Ethical investing means to prioritize one's ethical beliefs when selecting securities for investment, based on an ethical code which can also be related to religious values. Vice versa, with unethical investing, it is possible to encourage bad practices.

The attempt to combine these priorities into a unified definition appears to create challenges in the methodology utilized by researchers when comparing the returns of SRI with those of conventional investments.

An important issue to consider is not only the criteria that investors use to make decisions, but also their underlying motivations that influence their choice of essential SRIs. A recent development focuses on measuring and managing performance in terms of social benefit as well as investment returns: from a financial perspective, investors are attracted to ethical funds as they can potentially generate similar or even superior returns compared to conventional ones. Therefore, investors choose to invest in SRI

[59] Global Reporting Initiative (GRI) (2013), "G4 Sustainability Reporting Guidelines: Reporting Principles and Standard Disclosures", Amsterdam: Global Reporting Initiative

[60] Jansson M., Sandberg J., Biel A., Gärling T.J. (2014), "Should pension funds' fiduciary duty be extended to include social, ethical and environmental concerns? A study of beneficiaries' preferences", in Journal of Sustainable Finance & Investment, Vol. 4(3) (pp. 213-229)

[61] Junkus J., Berry T.D. (2015), "Socially responsible investing: a review of the critical issues", in International Journal of Managerial Finance, Vol. 41(11) (pp. 1176-1201)

with the goal of maximizing their returns and gaining financial advantages[62]. This is known as "impact investing," which aims to promote a social good while also making efficient use of resources by using methods such as benchmarking. Impact investing has been considered by some as an emerging alternative asset class, as it often involves direct investment in individual companies or organizations, with mentoring of their leaders. As a result, these unique investments may be more like venture capital and private equity (where the concept of impact investing originated) and may not be highly correlated with traditional assets such as stocks or bonds. It complies investing in companies which have an impact on upholding ESG principles, with a more active approach than ethical investing.

Nowadays, is of utmost importance the concept of shareholder activism: individual and institutional shareholders are more willing than ever to put pressure on businesses to follow socially responsible business practices. In some circumstances, having a good social reputation may make a business more appealing to investors who may not have previously thought about it and a growing number of investors see sustainable strategies as a competitive advantage, and the lack of one as a risk.

Advocates for shareholders may submit shareholder resolutions on issues like corporate governance, global warming, political donations, the environment, and labour practices. As a result of the Dodd-Frank financial reforms, the Securities and Exchange Commission adopted the so-called "say on pay" rule, which gave such activism a boost. Companies must allow shareholders to vote on executive compensation at least once every three years if they are over a certain size. Despite the vote's non-binding nature, institutional investors might have a stronger voice in advancing other causes if it were to pass[63].

[62] Chatzitheodorou K., Skouloudis A., Evangelinos K., Nikolaou I. (2019), "Exploring socially responsible investment perspectives: A literature mapping and an investor classification", in Sustainable Production and Consumption, Vol. 19 (pp. 117-129)

[63] Trustco Bank (2022), "Socially Responsible Investing", Albany, NY, January

2.2 - From risk to opportunity: run to a sustainable finance

The conventional approach to finance emphasizes solely on the financial gain and treats the financial sector as detached from the environment and society in which it operates. In contrast, sustainable finance considers the financial, social, and environmental returns collectively.

Why is it important for finance to contribute to sustainable development? The financial system's primary function is to allocate resources to their most productive use. By directing investments to sustainable companies and projects, finance can play a key role in accelerating the transition to a circular economy with low carbon emissions.

Sustainable finance considers how finance, including investing and lending, interacts with economic, social, and environmental factors. In the allocation role, finance can assist in making strategic decisions that balance sustainable goals. Additionally, investors can influence the practices of companies in which they invest, guiding them toward more sustainable practices. Finance is also adept at pricing risk for valuation purposes, which can help address uncertainty about environmental issues, such as the impact of carbon emissions on climate change. Both finance and sustainability focus on the future[64].

To achieve the investment scale necessary to reach the EU's climate and energy targets, private capital should be directed towards sustainable investments. The EU's ten-point action plan on financing sustainable growth suggests incorporating sustainability into investment advice provided to retail investors to encourage socially responsible investments in the retail sector. This is important because many interested investors do not currently invest sustainably due to a lack of supply from their current financial service provider and insufficient information on the matter[65].

---

[64] Schoenmaker D. (2017), "From Risk to Opportunity: A Framework for Sustainable Finance", Rotterdam School Of Management, Erasmus University, September

[65] Gutsche G., Zwergel B. (2020), "Investment barriers and labeling schemes for socially responsible investments", in Schmalenbach Business Review 72, February (pp. 1-47)

Transitioning towards sustainable finance entails moving away from the current financial system. Some of the obstacles to sustainable finance are short-termism, lobby against change by incumbent companies, and aversion to change.

According to Carney (2015): "*The tragedy of the short-term horizon is a major obstacle to sustainable finance*[66]". This refers to the fact that the costs of acting towards sustainability are immediate, while the benefits are often seen only in the distant future. Economic activities can have long-term impacts on society and the environment, but the time horizon of managers and investors in traditional finance is usually oriented towards short-term goals. The changes entail incorporating social and environmental considerations into decision-making and shifting the focus of decision-making from short-term to long-term. The short-termism is reinforced by practises like quarterly financial reporting by companies, variable pay systems based on annual results, monthly or quarterly benchmarks for measuring investor performance, marking-to-market of investments, supervisory treatment of illiquid investments, long and complicated investment chains, short political horizon, etc.

The adoption of these practices presents a challenge for the shift towards sustainable finance. The efficient markets hypothesis, which asserts that stock prices reflect all relevant information and, therefore, the long-term fundamental value of a company on average[67], underpins these practices: it further strengthens the emphasis on stock price as a key performance indicator for executives and investors.

Behavioural change is necessary for the sustainable development agenda[68]; there is a general reluctance to change that is connected to the issue of short-termism. Incumbent companies lobby to maintain the status quo and protect their assets, which hinders change. Examples of this include the oil industry lobbying against electric cars in

[66] Carney M. (2015), "Breaking the Tragedy of the Horizon – climate change and financial stability", in Speech at Lloyd's of London, 29 September

[67] Fama E. (1970), "Efficient Capital Markets: A Review of Theory and Empirical Work", in Journal of Finance, Vol. 25(2) (pp. 383-417)

[68] Barr S., Gilg A., Shaw G. (2011), ''Helping People Make Better Choices: Exploring the behaviour change agenda for environmental sustainability", in Applied Geography, Vol. 31(2) (pp. 712-720)

California in the 1990s[69], and the steel industry lobbying against the EU's Emissions Trading Scheme[70]. The Global Climate Coalition and the Council for Tobacco Research are also mentioned as examples of businesses that opposed action to reduce carbon emissions and promoted misleading science. NGOs like the Climate Action Network and shareholder engagement can be used to counteract this lobbying.
As a solution, investors can engage with companies through shareholder involvement and urge them to cease their lobbying activities. If unsuccessful, the investors may opt to exclude such companies.

2.3 - Greenwashing? Explicit sustainability mandates

The rise of green markets has been accompanied by the phenomenon of greenwashing, defined as "*the intersection of two firm behaviours: poor environmental performance and positive communication about environmental performance*[71]".
Companies, driven by the worsening environmental issues, have started developing and selling green products for customers who are more frequently asking for environmental-friendly outputs[72]. However, some of these companies deceive their stakeholders by engaging in a practice known as greenwashing, a phenomenon that has been widely discussed by researchers from various fields, including business, communication, economics, production engineering, social sciences, environmental management, and law, due to its multidisciplinary nature. However, there is no widely accepted general definition of greenwashing to this day.
In the last decade, stakeholders such as investors, consumers, governments, and corporate customers have been exerting more pressure on companies to disclose their

---

[69] Brown M.B. (2001), "The Civic Shaping of Technology: California's Electric Vehicle Program" in Science, Technology, & Human Values, Vol. 26, No. 1 (pp. 56-81)
[70] Adrien T. (2021), "Heart of steel: how trade unions lobby the European Union over emissions trading", in Environmental Politics, Vol. 30(7) (pp. 1217-1236)
[71] Delmas M., Burbano V. (2011), "The drivers of greenwashing", in California Management Review, Vol. 54(1) (pp. 65)
[72] Marquis C., Toffel M., Zhou Y. (2016), "Scrutiny, norms, and selective disclosure: a global study of greenwashing", in Organization Science, Vol. 27(2) (pp. 483–504)

environmental performance information and environmental impact. This communication should be dynamic, using various channels and aimed at raising awareness[73].

To enhance their image as environmentally conscious and socially responsible, certain companies invest in green marketing communications. Their advertisements and corporate social responsibility activities aim to improve their brand attitudes and purchase intentions but the actual situation regarding corporate environmentalism may not be as promising as it appears. A report showed that 95% of products claiming to be environmentally friendly in Canada and the USA are guilty of at least one of the "sins of greenwashing," ranging from the sin of the hidden trade-off to the sin of worshiping false labels[74].

Regulations on greenwashing are more established in developed countries with higher environmental awareness compared to developing countries where there is often a lack of or weak green regulations by the government, despite a general lack of concern for environmental issues among the population.

Greenwashing is also defined by Delmas and Burbano (2011) as the act of misleading consumers regarding the environmental practices of an organization (firm-level) or the environmental benefits of a product or service (product/service-level)[75]. General Electric's "Ecomagination" campaign[76] is an example of firm-level greenwashing because while it promoted the company's environmental practices, it also lobbied against new clean air EPA requirements. On the other hand, LG's Energy Star refrigerators[77] is an example of product/service-level greenwashing because 10 models were found to be mis-certified as energy efficient.

[73] Antunes D., Santos A., Hurtado A. (2015), "The communication of the LCA: the need for guidelines to avoid greenwashing", in Espacios, Vol. 36(5)

[74] TerraChoice (2010), "The sins of greenwashing: home and family edition", a report on environmental claims made in the North American consumer market

[75] Delmas M., Burbano V. (2011), "The drivers of greenwashing", in California Management Review, Vol. 54(1) (pp. 64-87)

[76] Available from: https://hbr.org/2014/08/ges-failure-of-ecomagination (accessed on 24 April 2023)

[77] Available from: https://casetext.com/case/lg-electronics-usa-v-department-of-energy (accessed on 24 April 2023)

Most of the research done so far has concentrated on greenwashing claims at the product/service level, which employs textual arguments that either directly or indirectly mention the environmental advantages of a product or service to create a deceptive environmental assertion[78].

Parguel et al. (2015) identified a different form of greenwashing known as "Executional Greenwashing", which involves the use of nature-inspired elements such as colours (e.g., green, blue), sounds (e.g., sea, birds), and images of natural landscapes (e.g., mountains, forests, oceans), endangered animals (e.g., pandas, dolphins), or renewable energy sources (e.g., wind, waterfalls) without making any explicit or implicit environmental claims[79]. Whether intentional or not, these nature-evoking elements have the potential to create false perceptions of a brand's environmental friendliness triggering ecological inferences through nature imagery.

On the other hand, some academics have highlighted the potential benefits of greenwashing. Holmes (2017) presented a different perspective on greenwashing, suggesting that certain outcomes of the practice may be beneficial for sustainability. For instance, some products marketed as safer or more eco-friendly may not be entirely green, but they can still contribute to a reduction in plastic usage or waste in the short term. Moreover, greenwashing may help raise awareness of environmentally friendly products among a wider audience[80].

Some argue that greenwashing can serve as a starting point for promoting sustainability. According to Gerner (2020), companies and brands may initially make small green efforts as part of a long-term goal for sustainability, but they are often accused of greenwashing in the short term. Over time, these small steps may lead to a genuine commitment to sustainability[81]. Policymakers should differentiate between small steps for sustainability and outright fraudulent claims.

---

[78] Freitas Netto S.V., Sobral M.F.F., Ribeiro A.R.B. et al. (2020), "Concepts and forms of greenwashing: a systematic review.", in Environmental Sciences Europe, Vol. 32(19)

[79] Parguel B., Benoit-Moreau F., Russell C. (2015), "Can evoking nature in advertising mislead consumers? The power of executional greenwashing", in International Journal of Advertising, Vol. 34(1) (pp. 107-134)

[80] Available from: https://earth911.com/business-policy/greenwashing-good/ (accessed on 26 April 2023)

[81] Available from: https://www.raconteur.net/sustainability/greenwashing-really-bad/ (accessed on 26 April 2023)

Unfortunately, the financial benefits of utilizing greenwashing tactics incentivize more companies to employ it as a rapid escape from sustainability[82].

To conclude, in the short term, greenwashing can serve as a gradual pathway towards sustainability. The short-term adoption of sustainable practices can be challenging for many firms and brands, as they may lack access to innovative green technologies and energy sources. Furthermore, there will always be waste after production and consumption.

Policymakers should take a comprehensive approach when detecting the deceptive practices of greenwashing and implement measures on a global scale to hold firms accountable for their misleading actions. In doing so, different measures tailored to specific firm activities should be taken into consideration. The intention of firms should be carefully assessed, and a gradual transition towards sustainability should be encouraged. On the other hand, rapid disengagement from sustainable practices should be strongly discouraged. Policymakers can provide support to firms that engage in legitimate green practices, while also working to combat green scepticism among consumers by providing guidance on sustainable products[83].

2.4 - Evolving trend of ESG investing: a look at BlackRock and Norway's sovereign wealth fund communication development

The field of ESG development has been widely accepted by major institutional investors and regulators, building upon the framework established by early pioneers. Consequently, it has become a well-established field that companies cannot afford to ignore.

BlackRock, Inc. is the largest asset manager globally, responsible for 9 trillion euros in assets under management. In 2021, approximately 30% of these assets involved ESG

[82] Available from: https://grist.org/article/greenwashing-is-better-for-business-than-real-sustainability-efforts/ (accessed on 29 April 2023)

[83] Yildirim S. (2023), "Greenwashing: a rapid escape from sustainability or a slow transition?", in LBS Journal of Management & Research

integrated active and advisory strategies across 1,200 sustainability matrices[84]. Since 2012, BlackRock's CEO, Larry Fink, has published an annual letter to global CEOs, covering various themes crucial to creating long-term value for a company's shareholders.

The 2012 letter emphasized the importance of good corporate governance practices for long-term business performance: the company should be transparent and honest with shareholders on governance issues and take their feedback into consideration at shareholder meetings. In 2014-2015, Fink discouraged companies from cutting short-term capital expenditure to increase dividends and share buybacks, stating that it could harm long-term results. The letter also mentioned BlackRock's revised proxy voting guidelines that voted against directors where there was evidence of short-termism affecting ineffective corporate governance. In 2016, he encouraged CEOs to develop a strategic framework for long-term value creation instead of prioritizing dividends and share buybacks. He also urged companies to focus on long-term considerations like navigating the competitive landscape, technological disruption, and relevant financial metrics. Fink mentioned ESG for the first time, stating that they were important to have a quantifiable financial impact, and BlackRock planned to integrate them into the investment process. In 2017, Fink's letter to CEOs focused on globalism and urged them to include macroeconomic themes in their strategic review and long-term considerations. This was in response to events such as the UK's Brexit vote, former US President Trump's focus on domestic trade policies and tax reforms, and growing backlash against globalization and technological changes. In 2018, Fink emphasized the importance of purpose and introduced a new model for corporate governance where companies should consider their overall purpose and approach to stakeholders, including their role in the community and impact on the environment. In the 2019 letter, Fink emphasized the connection between purpose and profit and the importance of considering all stakeholders to achieve long-term profitability. He discussed social

[84] BlackRock (2021), "2021 Sustainability Disclosure: Reporting under the Sustainability Accounting Standards Board ("SASB") Standards and Management Criteria"

justice, public pressures, a new generation of investors, and leadership in this context. In the 2020 letter, Fink highlighted climate risk as an investment risk and emphasized the importance of integrating sustainability into portfolios. BlackRock also made ESG funds standard building blocks for multi-asset solutions and adopted more systematic active management solutions for ESG. In the 2021 letter, Fink emphasized the need for companies to meet the scientifically established threshold targets for global warming and the importance of the Task Force on Climate-related Financial Disclosures (TCFD) framework for increasing transparency on ESG data and disclosure. The focus was on not only performing well on ESG matrices but also reporting the status transparently. In the 2022 letter, Fink argues that capitalism is driven by mutually beneficial relationships and companies should include all stakeholders in their strategy and purpose. He sponsors a Centre for Stakeholder Capitalism and emphasizes that companies that do not embrace their stakeholders will witness diminishing market opportunities[85].

The communication has maintained its emphasis on generating long-term value, but the topics have evolved from matters such as corporate governance, capital allocation, short-term thinking, and global risks to an ESG framework or stakeholder model with a steadfast purpose and non-financial disclosures. The latest themes in 2021 and 2022 centre around the transparency of non-financial reporting, a view supported by the US Government Accountability Office's declaration in July 2020 which state that investors require better ESG information, rather than more of it[86].

Larry Fink has been instrumental in leading institutional investors towards embracing ESG, as evidenced by his annual letters and BlackRock's integration of ESG into its investment process.

Norway's sovereign wealth fund, which in 2022 managed 1.3 trillion euros and is the world's largest shareholder, serves as a financial tool for the Norwegian government

[85] Lykkesfeldt P., Kjaergaard L.L. (2022), “Institutional Investors Are Embracing ESG Strategies”, in Investor Relations and ESG Reporting in a Regulatory Perspective, August (pp. 255–259)

[86] U.S. Government Accountability Office (GAO) (2020), “Public companies: Disclosure of environmental, social and governance factors and options to enhance them”, GAO-20-530

savings and has evolved from a diversified portfolio strategy to an active ownership model focused on responsible investing over the past two decades. The fund owns 1.5% of all global equity listed companies on average and has a portfolio of approximately 9,000 companies in 73 countries[87]. The fund implements an ESG framework to identify, measure, and manage ESG-related risks, with an investment philosophy of establishing a standard filter through established principles, exercising ownership by discharging obligations to vote at company Annual General Meetings (AGMs), and implementing ongoing investor dialogue. The fund has a transparency and exclusion framework, screening and monitoring companies that fit its policy standards, and maintaining a live-updated list of companies it owns, the reasons they are held, ethical concerns, and the fund's voting record on their AGMs. The fund has moved from a classical investment shareholder model to a stakeholder-driven model, with exclusion themes ranging from human rights to climate change. For Investor Relations Officers, it is crucial to recognize the high level of transparency established by the fund, as well as the exclusion themes and considerations that offer good early indicators for a company's strategic, communicative, and IR perspective[88].

BlackRock and Norway’s sovereign wealth fund recent actions are clear examples that showcase the stages in the evolution of institutional investors' perspectives oriented on ESG over the last decade.

All companies will be affected by the transition to a net zero economy and companies with a well-articulated long-term strategy, and a clear plan to address the transition to net zero, will distinguish themselves with their stakeholders. Those that don’t will see their businesses and valuations suffer.

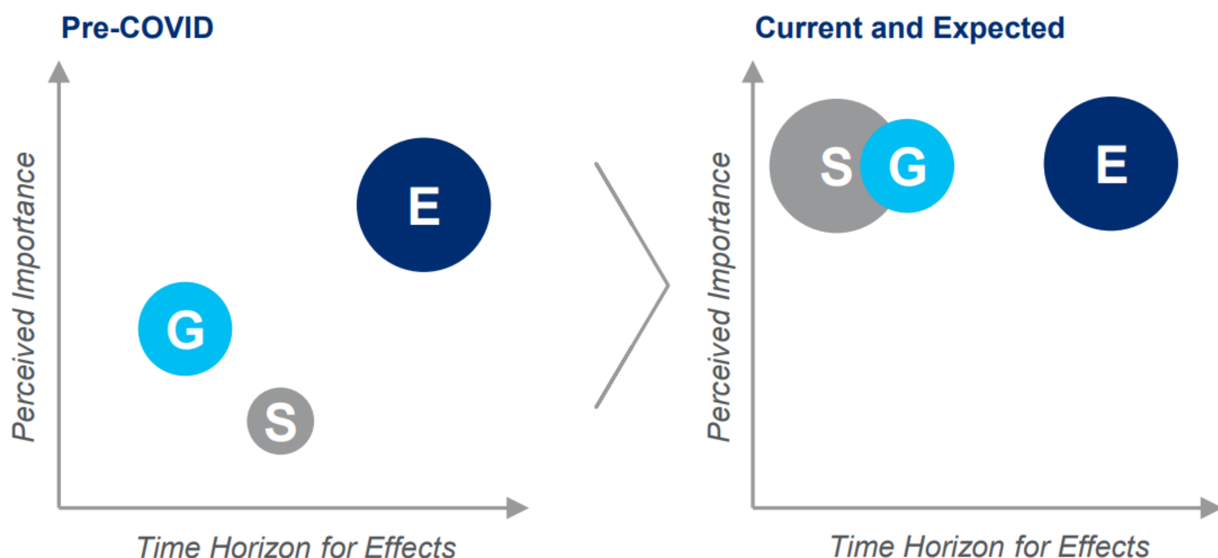
[87] Available from: https://www.weforum.org/agenda/2022/09/norways-massive-sovereign-wealth-fund-sets-net-zero-goal/ (accessed on 20 May 2023)

[88] Available from: https://www.reuters.com/business/sustainable-business/companies-should-take-more-action-climate-norways-sovereign-fund-says-2021-12-01/ (accessed on 29 April 2023)

2.5 - The increasing importance of “S” factor

It is interesting to mention that the COVID-19 pandemic has emerged as a new catalyst in the financial conversation, highlighting the importance of the often-neglected "S" factor in ESG. It has brought attention to the social issues of economic, racial, and gender inequality that have been historically overlooked, and magnified their impact on vulnerable groups. With growing social movements and awareness, the COVID-19 era has become a pivotal moment in acknowledging the extensive social inequality and the widespread need to address it[89]. Some social issues may require more immediate attention than topics related to "E" or "G".

Graph 2: Social becoming as important as environmental (Citi's April report, 2020)



Standard-setting organizations such as Sustainability Accounting Standards Board (SASB) and GRI have developed frameworks for social issues in ESG, which focus on the impact of organizations on the social systems in which they operate. GRI's social category covers sub-categories like labour practices, human rights, society, and product

[89] Baid V., Jayaraman V. (2022), “Amplifying and promoting the ‘S’ in ESG investing: the case for social responsibility in supply chain financing”, in Journal of Managerial Finance, Vol. 48(8)

responsibility, based on universal standards and international references[90]. The SASB framework divides ESG issues into five dimensions and twenty-six general issue categories, including social capital (human rights, community relations, customer privacy, etc.) and human capital (labour practices, employee health, diversity, and inclusion, etc.)[91]. Studies show that organizations that provide SASB-identified sustainability disclosure have better stock price informativeness, indicating that this disclosure contains more financially relevant and firm-specific information[92].

During this crisis, companies are being judged on their social responsibility and how they behave to their staff, their customers, their suppliers and to their communities. To ensure the financial security and health safety of employees, it is recommended that the company safeguard work contracts and wages, offer alternative work arrangements, provide health access, paid sick leave, protect frontline workers, offer hazard pay, and encourage social dialogue within the organization. Additionally, to prevent job losses, the company should adjust operations and reduce overhead costs, redirect staff towards other sectors in need, and hire and train staff. Furthermore, the company should lead by example and engage with governments, stakeholders, and communities by pledging to direct all government aid to protect employees' job retention, cutting dividends and share buybacks, and reducing executive compensation.

If we focus more on the "S" aspect of ESG, we can better understand the impact of organizations. This can be achieved by implementing strong measurement and metrics to better comprehend social outcomes, leading to strategic changes in organizations that will be sustainable in the future. However, organizations must strike a balance between consistent social reporting requirements that enhance transparency and commitment, while also being flexible enough to respond to changing community needs.

[90] GRI (2013), "Sustainability G4 Reporting Guidelines", Implementation Manual

[91] Sustainability Accounting Standard Board (SASB) (2018), "Standards overview", in SASB Standards Application Guidance

[92] Grewal J., Hauptmann C., Serafeim G. (2021), "Material sustainability information and stock price informativeness", in Journal of Business Ethics, Vol. 171, No. 3 (pp. 513-544)

2.6 - ESG investing approaches and strategies

There is a growing trend of investment products or strategies that combine multiple sustainable investment approaches. The methods employed for investing funds through an ESG lens are still in the process of developing and evolving. The elementary approaches involve excluding certain companies, whereas the more advanced techniques incorporate ESG metrics and objectives in conjunction with financial information.

Specific ESG screens may be utilized to exclude companies whose products or actions are considered harmful to the public good. For instance, companies involved in alcohol, tobacco, gambling, firearms, environmental pollution, or with significant interests in countries with oppressive governments are often excluded from socially responsible funds[93].

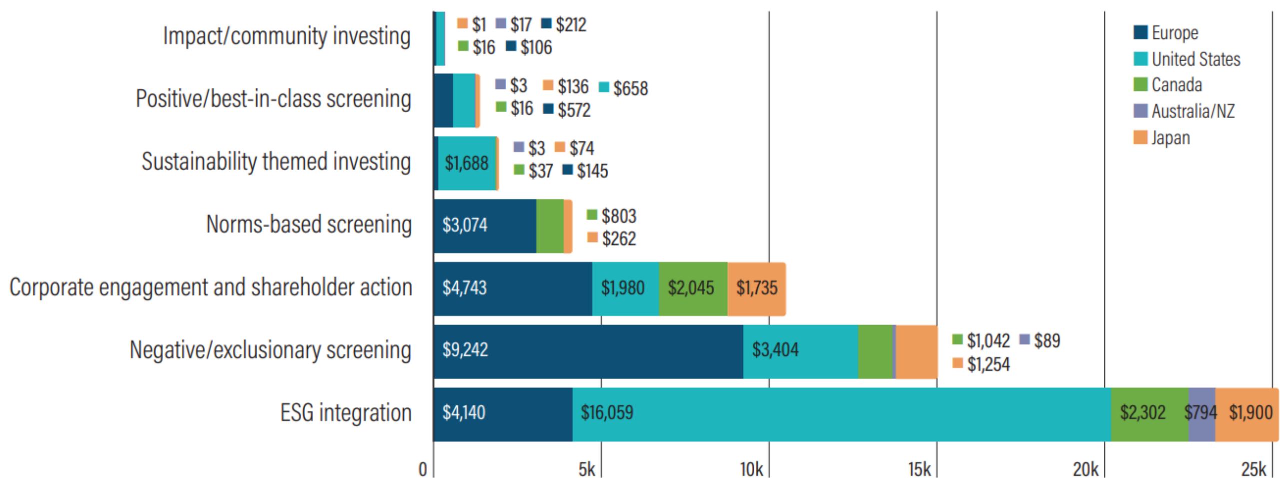
However, as interest in socially responsible investing has grown, the screening process has become more positive, and it involves selecting best-in-class environmentally and socially responsible businesses. ESG screens are now used to identify companies whose practices actively contribute to a particular social good, such as protecting the environment, implementing sustainable practices, or prioritizing community and employee relations[94].

ESG integration is currently the largest sustainable investment strategy worldwide, with USD 25.2 trillion in assets under management. It is also the most frequently reported strategy in most regions. Negative/exclusionary screening, with USD 15.9 trillion, and corporate engagement/shareholder action, with USD 10.5 trillion, are the next most common sustainable investment strategies. This marks a shift from 2018, when negative/exclusionary screening was reported as the most popular sustainable investment strategy.

[93] Kolstad I. (2016), "Three questions about engagement and exclusion in responsible investment", in Business Ethics: A European Review, Vol. 25, No. 1 (pp. 45-58)

[94] González J.M.C., Ruiz F., Paz M.R., Blanca P.G. (2014), "Interactive socially responsible portfolio selection: an application to the Spanish stock market", in Information Systems and Operational Research, Vol. 52(3) (pp. 126-137)

Graph 3: Sustainable investing assets by strategy & region (GSIA, 2020)[95]



ESG integration is a sustainable investment strategy that involves incorporating ESG factors into the portfolio construction process. In this approach, ESG scores are added as variables in factor-driven portfolio construction, with weights determined based on financial factors and ESG scores. This allows investors to evaluate companies based on both financial and non-financial factors. ESG integration is highly flexible, and there are different approaches to integrating ESG scores. The first approach is embedding ESG, where ESG factors are included alongside financial factors when constructing the portfolio. The second approach is filtering based on a blended score, where companies are filtered based on an overall ESG score that is a combination of environmental, social, and governance factors. The third approach is filtering based on individual E, S, or G scores, where investors focus on specific ESG factors that are most relevant to their investment objectives. Overall, ESG integration aims to create a more sustainable and responsible investment portfolio[96].

The Corporate Engagement & Shareholder Action approach involves using equity ownership to engage companies directly on corporate behaviour, strategy, and

[95] Global Sustainable Investment Alliance (GSIA) (2020), "Global Sustainable Investment Review 2020", report No. 5, November

[96] Aldowaish A., Kokuryo J., Almazyad O., Goi H.C. (2022), "Environmental, Social, and Governance Integration into the Business Model: Literature Review and Research Agenda" in Sustainability, Vol. 14(5)

commitments. This approach includes efforts such as stewardship, shareholder engagement, and the use of shareholder resolutions to effect change. However, the effectiveness of such efforts may be difficult to measure or quantify. In this approach, investors use their shareholder power to encourage companies to improve their ESG practices and create positive social and environmental impact. It is a proactive approach that involves investors actively engaging with companies and promoting change[97].

Positive/Best-in-Class screening is a sustainable investment strategy that uses ESG data to identify companies that are industry leaders in terms of their ESG practices. This approach requires knowledgeable managers who can pinpoint the non-financial risks they are looking to address. Due to the lack of third-party off-the-shelf data providers, managers often supplement official information with bespoke data inputs. The goal of this approach is to invest in companies that are leaders in ESG performance, rather than simply excluding those with poor ESG practices. This approach is also known as the "best-of-sector" or "positive screening" approach[98].

In conclusion, the growing prominence of ESG investing has led to a shift in the strategies utilized by investors. While exclusionary screenings were once the norm, today's ESG investors are increasingly turning to more sophisticated approaches that consider ESG factors as a part of a broader investment strategy. This allows investors to not only avoid companies that are harming society or the environment, but also to identify those that are leading the way in terms of sustainability and social responsibility. Overall, the increasing accuracy of ESG investment strategies is a positive development for both investors and society.

[97] Direction S., (2023), “How investors can drive corporate sustainability efforts: Shareholder engagement as an effective approach” in Journal of Strategic Direction, Vol. 39, Issue 2

[98] Torricelli C., Bertelli B. (2022), “ESG screening strategies and portfolio performance: how do they fare in periods of financial distress?” in CEFIN Working Papers, Università di Modena e Reggio Emilia, Dipartimento di Economia "Marco Biagi"

2.7 - ESG and financial performance: the impact on M&A activity

The impact of ESG performance on corporate value has garnered significant attention in recent research on environmental, social, and governance issues. Studies have focused on the impact of environmental performance, social responsibility performance, and corporate governance performance on corporate value, revealing that improving ESG performance can enhance market value of a company. Additionally, companies with strong ESG performance tend to have more stable market values and more resilient stock prices in the face of extreme risks such as the financial crisis or global pandemics like COVID-19[99].

Companies with strong ESG profiles are likely to be more competitive than their peers due to their efficient use of resources, better human capital development, and improved innovation management. They are also better at developing long-term business plans and long-term incentive plans for senior management. Moreover, these companies exhibit above-average risk control and compliance standards, which result in lower stock-specific downside or tail risk in the company's stock price. In addition, they tend to have higher profitability and, in many cases, higher dividends, as compared to their counterparts. These characteristics of companies with strong ESG profiles suggest that integrating ESG factors into a company's operations and strategy can lead to better business performance and financial outcomes[100].

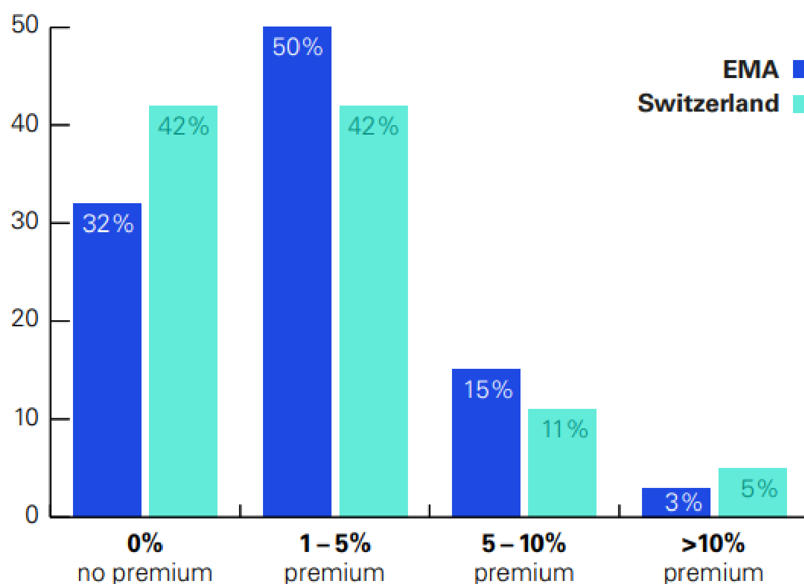
Companies with strong ESG profiles have additional characteristics that make them attractive to investors. These companies are less vulnerable to systemic market shocks, which means that they should exhibit lower systematic risk. As a result, they have lower beta, which translates to a lower cost of capital and subsequently a higher valuation. This leads to a larger investor base, because of more transparency, particularly with relation to their risk exposures. These companies are also catering to a growing number of socially conscious and risk-averse investors who avoid exposure

[99] Zhou G., Liu L., Luo S. (2022), “Sustainable development, ESG performance and company market value: Mediating effect of financial performance”, in Business Strategy and the Environment, Vol. 31, Issue7, November (pp. 3371-3387)
[100] McKinsey (2019), “Five ways that ESG creates value”, Quarterly report, November

to low ESG ranked companies. Therefore, companies with strong ESG profiles have an advantage in attracting capital, both from traditional investors and from those seeking to align their investments with their values[101].

It is important to stress that lately, ESG criteria influence a growing number of M&A transactions, with investors willing to pay premiums for targets with strong sustainability stories. In the EMA region, over 66% of 150 dealmakers surveyed by KPMG expressed a willingness to pay a premium for a company that exhibits a strong ESG track record in areas that match their ESG priorities. A similar trend was observed among participants from Switzerland, though to a slightly lower degree.

Graph 4: As a buyer, how much more would you be willing to pay for a target that demonstrates a high level of ESG Maturity in line with your ESG priorities? (KPMG, 2023)[102]



A new and very fast changing issue in that field, which can dramatically impact the valuation during mergers and acquisitions consists in assessing the climate change costs and opportunities. Boards of directors have a fiduciary duty to safeguard corporate assets and to ensure the long-term sustainability of the business models they are responsible for managing. Climate change and greenhouse gas emissions are two

[101] Giese G., Lee L.E., Melas D., Nagy Z., Nishikawa L. (2019), "Foundations of ESG Investing: How ESG Affects Equity Valuation, Risk and Performance", in Journal of Portfolio Management, Vol. 45(5), July

[102] KPMG (2023), "ESG due diligence in M&A", in Clarity on Mergers & Acquisitions 2023, January

of the leading factors that many shareholders and investors are scrutinizing, creating pressure on companies to address these issues effectively: when companies acquire targets with a low ESG profile, cultural tensions may rise between employees and stakeholders' community (especially referring to cross-border operations). As a result, M&A teams increasingly conduct ESG due diligence on targets at an early stage. It is essential to give confidence to all parties involved in an M&A transaction that the project will meet both stakeholder expectations and regulatory requirements in the future: compliance with regulations and adherence to ESG principles are now a significant focus of attention. Improving the company's ESG profile may be the primary driver in the strategic rationale for a transaction, with investors considering a company's ESG track record before deciding to engage in a deal. This is a new area in terms of synergies, where ESG is seen not only as an opportunity, but also as a driver to capture value.

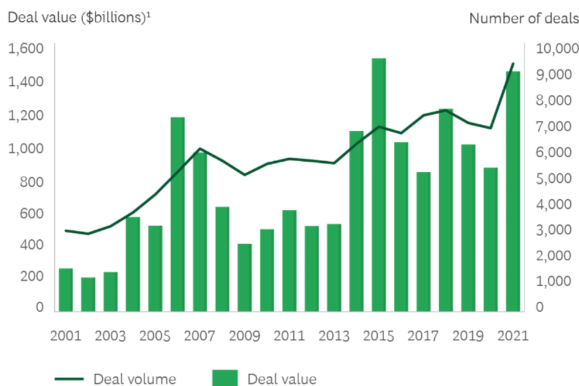
If a company develops its own ESG strategy, or did develop its strategy already, it will likely focus on ESG considerations for its M&A strategy as well: an industrial company that would like to transition to new technologies, which will help to reduce CO2 emissions or develop cleaner processes, will look to acquire business with that kind of organisation in this area or a company may decide to sell a certain business no more aligned with its strategy and develop an ESG strategy. In 2021, major energy companies such as Royal Dutch Shell, BP, and Public Service Enterprise Group (PSEG) have been restructuring their businesses in response to the need to reduce carbon emissions and transition to renewable energy sources. For example, Royal Dutch Shell sold its Permian Basin assets to ConocoPhillips to lower its global carbon emissions, while BP committed to divesting USD 25 billion of assets by 2025 and has already divested a stake in its Omani gas fields and oil interests in the U.K. North Sea. Similarly, PSEG has divested its fossil fuel plants as part of its pivot to renewables[103].

[103] Brownstein A.R., Lu C.X.W. et al. (2022), "ESG and M&A in 2022: From Risk Mitigation to Value Creation", in Harvard Law School Forum on Corporate Governance, January

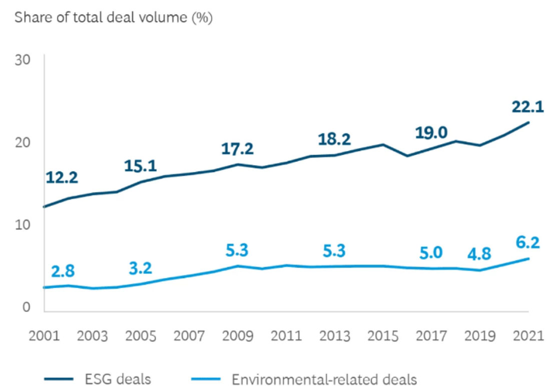
ESG deals globally experienced a significant increase in volume from around 5,700 in 2011 to a record high of approximately 9,200 in 2021, indicating a 60% surge. The rise in activity was particularly robust in 2021, with a 35% increase in deal volumes following two years of weak performance for both general M&A and ESG transactions, while the volume of ESG-related deals as a share of all deals rose from 12% in 2001 to 17% in 2011 and to 22% in 2021.

Graphs 5,6: ESG is gaining importance in M&A (BCG, 2022)[104]

The volume and the value of ESG deals have risen over the past two decades



The shares of ESG deals and environmental-related deals have grown continuously



Therefore, it is vital to recognize that ESG and M&A are inextricably linked, and companies that fail to consider ESG factors in their M&A decision-making may face significant challenges and risks.

The technology, media, and telecommunications (TMT) sector, energy sector, healthcare sector, and financial institutions have all been recently involved in M&A deals that have incorporated ESG considerations.

In conclusion, ESG issues have become critical in M&A transactions, and companies that prioritize ESG concerns will be better placed to capture value and succeed in today's business environment, appealing as attractive entities able to diversify risks and look for new opportunities. Boards of directors must ensure that ESG factors are fully

[104] Available from: https://www.bcg.com/publications/2022/green-deals-on-the-rise-according-to-the-latest-mergers-and-acquisitions-report (accessed on 15 May 2023)

integrated into their strategic decision-making processes, and companies must be prepared to demonstrate compliance with ESG regulations and best practices to succeed in the modern marketplace.

2.8 - The growth in responsible investments regulation and policy in Europe

Sustainability factors, such as the widely recognized ESG pillars, were introduced in international declarations and covenants after World War II. The Universal Declaration on Human Rights in 1948 and the International Covenant on Economic, Social, and Cultural Rights in 1966 established the first framework of regulations for social factors ("S"), which encompassed the protection and respect of human, social, and cultural rights. These acts reflected significant international political agreement among governing states regarding the defining nature of ESG factors. Despite not being legally binding instruments, they represented the initial milestone in the development of ESG factors, which was subsequently expanded in the 1990s to include environmental issues ("E") and, in the last decade, governance ("G")[105].

It is only in 2010 that the ESG framework was consolidated at the EU level, with the adoption and implementation of specific mandatory regulations, known as "hard law" (for example: "EMAS" Regulation 2009/1221; "Timber" Regulation 2010/995; "Conflict minerals" Regulation 2017/821). However, the adoption of the United Nations' 2030 Agenda and the Paris Agreement in 2015 marked a significant shift in the timeline of ESG. This year characterized the beginning of regulatory obligations that heightened investors' focus on social issues and sustainability[106].

Therefore, 2015 was a pivotal moment towards more well-defined sustainability measures, particularly in the financial sector. Following this, the EU began to prioritize sustainable development, with an emphasis on using private investors and companies

---

[105] Bengo I., Boni L., Sancino A. (2022), "EU financial regulations and social impact measurement practices: A comprehensive framework on finance for sustainable development" in Corporate Social Responsibility and Environmental Management, Vol. 29, Issue 4, January (pp. 809-819)

[106] Bauer R., Ruof T., Smeets P. (2021), "Get real! Individuals prefer more sustainable investments" in The Review of Financial Studies, Vol. 34(8) (pp. 3976-4043)

to address global issues and crises. To this end, a series of regulations were introduced to mobilize finance for climate and social-focused problems (the previously mentioned EU Action plan on financing sustainable growth in 2018; the European Green Deal in 2019; and the next generation EU[107] in 2020). The EU's strategy focused on redirecting investments towards sustainable technologies and long-term business models, which led to the creation of a series of regulations addressing ESG concerns.

More recently, the Non-Financial Reporting Directive (NFRD), the Sustainable Financial Disclosure Regulations (SFDR), and the EU Taxonomy are all essential for sustainability disclosure. These regulations mainly focus on identifying and mitigating sustainability risks and together they create the new sustainability landscape. The NFRD is particularly significant as it is the first ESG-related legislative text passed and acts as a conduct measure.

The NFRD, which entered into force in 2017, mandates large European companies to disclose their impact on ESG and vice versa. The scope of the NFRD includes European-listed and large public-interest companies. The current version of the directive requires them to publish reports on their policies regarding environmental protection, social responsibility, human rights, anti-corruption and bribery, and board diversity, and must cover both risks and associated mitigating activities[108].

The SFDR is a regulatory framework that has been in effect since December 2019 and enforced starting in March 2021. Its aim is to obligate companies to divulge ESG-related risks within their portfolio and allocate their products into categories that carry with them additional disclosure requirements. The SFDR rules are applicable to asset managers, financial advisors, and insurance providers operating within the European Union. This encompasses EU-based subsidiaries with parent companies based outside of the EU, as well as non-EU entities that market funds within the EU (for example,

[107] The Next Generation EU is an economic recovery plan of the European Union that aims to assist member states in recovering from the adverse impacts of the COVID-19 pandemic, especially those that have suffered the most severe effects

[108] European Commission (2021), "Directive of the European Parliament and of the Council Amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as Regards Corporate Sustainability Reporting", Brussels

firms like BlackRock, Vanguard, State Street). Furthermore, the regulations indirectly apply to managers offering portfolio management and/or investment advice services to EU firms. SFDR requires disclosure on investments' double materiality, due diligence of sustainability risks, integration of sustainability factors in remuneration policies, and transparency of adverse sustainability impacts at the entity and product level. Managers must classify their funds into one of three categories, with varying levels of disclosure requirements.

Figure 3: Double materiality: financial vs. ESG reporting (European Commission, 2019)[109]

SFDR aims to address greenwashing: by introducing a set of mandatory rules, it provides investors with greater transparency on how a fund is meeting ESG objectives. The main objective of SFDR is to promote transparency among companies regarding

[109] European Commission (2019), "Regulation (EU) 2019/2088 of the European Parliament and of the COUNCIL of 27 November 2019 on Sustainability-Related Disclosures in the Financial Services Sector", Articles 1,2,4,6,8,9, Brussels

sustainability risks that could potentially harm their investments, as well as the negative effects that their investments may have on ESG factors by quantifying more than a dozen mandatory “principal adverse impacts” (from gender diversity to CO2 emissions).

Taxonomies are systems of classification that establish criteria for recognizing assets, projects, and activities that have environmental or social advantages and disadvantages, including externalities. They send clear messages to investors and other stakeholders and help reduce the risk of greenwashing by establishing a shared vocabulary that investors can employ to channel funds towards sustainable objectives in different jurisdictions.

The EU Taxonomy aims to create consistent environmentally sustainable standards, working alongside the SFDR and NFRD. It is simply a dictionary which defines what is sustainable and what not, establishing criteria for environmentally sustainable economic activities, with six objectives for firms to contribute to: (i) climate change mitigation; (ii) climate change adaptation; (iii) the sustainable use and protection of water and marine resources; (iv) the transition to a circular economy; (v) pollution prevention and control; and (vi) the protection and restoration of biodiversity and ecosystems[110].

The Taxonomy applies to companies in the scope of NFRD or SFDR and requires reporting on the proportion of turnover, capital expenditure, or operating expenditure associated with sustainable activities, and KPIs for large financial companies. In 2022, investors managing ESG-related funds will have to explain how they use the EU’s green taxonomy to determine the sustainability of their investments; they will also have to disclose what percentage of their investments are in line with the taxonomy.

To conclude this brief digression on the development of regulation around the ESG theme, it is clear how ESG regulation has become increasingly important due to the need for change in corporate and investment practices. The EU has taken a leading role

[110] European Commission (2020), “Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the Establishment of a Framework to Facilitate Sustainable Investment, and Amending Regulation (EU) 2019/2088”, Brussels

in ESG regulation with stringent regulations on disclosure, accountability, carbon markets, due diligence, and investment activities. This has led to the so called "ESG Brussels Effect" where other countries are incorporating ESG regulations into policymaking[111]. The EU's regulatory power in ESG matters is impacting businesses globally due to its scope of regulation and membership in key global institutions. Regulatory cooperation and oversight are necessary to prevent greenwashing and regulatory arbitrage while promoting sustainable growth and achieving net-zero objectives.

[111] Alamillos R., de Mariz F. (2022), “How Can European Regulation on ESG Impact Business Globally?”, in Journal of Risk and Financial Management, Vol. 15(7)

CHAPTER 3

TOWARDS EFFECTIVE ESG LAW AND REGULATION: PATHWAYS FOR BROADER APPROACHES AND LONG-TERM SOLUTIONS

3.1 - The “Brussel Effect” and the need for standardize regulations

Improving the disclosure of climate-related information can bring various advantages to the reporting company itself. It enhances awareness and comprehension of climate-related risks and opportunities within the organization, resulting in better risk management, more knowledgeable decision-making, and improved strategic planning. It enlarges the investor base to encompass a more diverse range of investors and potentially decreasing the cost of capital: this may arise from being included in actively managed investment portfolios, sustainability-focused indices, and receiving better credit ratings for bond issuance, as well as better creditworthiness assessments for bank loans. It also promotes constructive dialogue with stakeholders, particularly investors and shareholders and boosts corporate reputation and sustaining the social license to operate[112].

As more evidence emerges indicating that ESG can be a lucrative strategy for companies and investors in terms of project selection and that corporate social responsibility can result in better financial performance, there is an opportunity for regulators to encourage and discourage certain behaviours to hasten the shift toward a lower-carbon economy. In the past decade, Europe has implemented substantial ESG regulations and is currently leading the way globally in ESG implementation.

The regulatory efforts have been focused not only on promoting ESG investment by encouraging investors to take into account environmental, social, and governance issues in their decision-making process, but also on enforcing ESG compliance among

[112] European Commission (2019), “Guidelines on non-financial reporting: Supplement on reporting climate-related information”, in Official Journal of the European Union; Information From European Union Institutions, Bodies, Offices and Agencies, C209/1

corporations and ensuring progress towards meeting the milestones of the Paris Agreement.

The involvement of corporations in addressing climate change is increasingly being demanded by shareholders and investors, as evidenced by the inclusion of climate change issues in proxy statements addressed to companies: this has led to increased ESG disclosure by corporations, particularly when driven by institutional investors, and even more so when driven by long-term institutional investors[113] (it has been proved that long-term institutional investors tend to prioritize CSR in their investment decisions)[114].

ESG-oriented objectives are also reflected in the various targets and strategies set by governments. The European Commission, for instance, is focused on expanding green infrastructure, while the European Central Bank is actively involved in promoting the green transformation of the financial system. These efforts are part of the Network for Greening the Financial System (NGFS), which includes the US Federal Reserve System and 83 other central banks and supervisors, as well as 13 observers. The member countries account for around 75% of global greenhouse gas emissions, and they oversee all systemically important banks worldwide, as well as two-thirds of internationally systemically important insurers. Through the exchange of best practices, the NGFS aims to improve the financial sector's environmental and climate risk management and facilitate the industry's transition toward a sustainable economy[115].

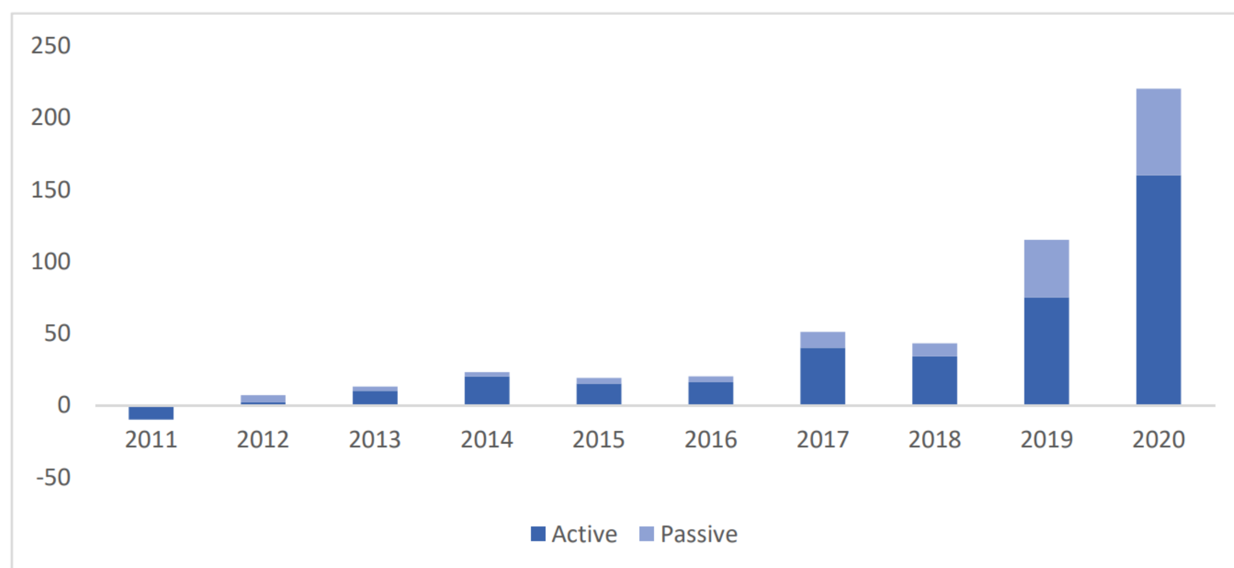
ESG funds experienced a surge in popularity in Europe, with a record inflow of USD 233 billion in 2020, nearly twice that of the previous year. To meet the demand, asset managers launched 505 new ESG funds and repurposed over 250 conventional funds.

[113] Flammer C., Toffel M.W., Viswanathan K. (2019), "Shareholder activism and firms' voluntary disclosure of climate change risks", in Strategic Management Journal, Vol. 42

[114] Boubaker S., Lamia C., Himick D., Saadi S. (2017), "It's about time! The influence of institutional investment horizon on corporate social responsibility", in Thunderbird International Business Review, No. 59

[115] Available from: https://www.ngfs.net/en/communique-de-presse/us-federal-reserve-joins-ngfs-and-two-new-publications-released (accessed on 6 May 2023)

Graph 7: Annual European Sustainable Fund Flows (EUR billion) (Hortense et al., 2020)[116]



In the US, ESG funds attracted around USD 49.9 billion in net inflows in 2020[117]. The "Brussels Effect" has been observed in Europe for several decades, where civil society and corporations have led the way in promoting ESG, eventually leading to government action. As a result, both the demand and supply for ESG investments have increased. Industry leaders are responding by providing more transparent and comprehensive sustainability reports, sharing information with ESG rating agencies, and publicly communicating their ESG commitments. The "Brussels Effect" phenomenon occurs when a regulatory framework is implemented in a specific sector by EU, prompting other regions to adopt similar regulations in order to participate in that market: an example of this phenomenon occurred with the General Data Protection Regulation (GDPR), which was implemented by the EU to safeguard consumer privacy and regulate data management and the strict set of standards set by the EU prompted some US companies to be more globally compliant due to the fear of being excluded from the EU market[118].

[116] Hortense B., Stuart E., Boyadzhiev D., Pettit A., Alladi A. (2021), "European Sustainable Funds Landscape: 2020 in Review. A Year of Broken Records Heralding a New Era for Sustainable Investing in Europe", in Morningstar Manager Research, February
[117] Available from: https://www.morningstar.com/articles/1035554/sustainable-fund-flows-reach-new-heights-in-2021s-first-quarter (accessed on 6 May 2023).
[118] Gady F.S. (2014). "EU/U.S. Approaches to Data Privacy and the "Brussels Effect": A Comparative Analysis", in Georgetown Journal of International Affairs Vol. 4 (pp. 12–23)

ESG development is accompanied by an increase in regulations, both within and outside the EU, not just among individual investors but also among institutional ones. Institutional investors, including JPMorgan and Wellington, are increasingly supporting ESG regulation, and pension funds are following suit, with Scottish Widows divesting from non-compliant companies[119]. In general, there is agreement that environmental protection should be improved, and meaningful action taken regarding climate change. Corporations also have a keen interest in implementing these protections in the most efficient manner possible, which is why more actionable steps are needed. It is not always a question of strictness or protection; rather, there may be a need to standardize regulations.

For a long time, American regulators have been hesitant to pass laws on ESG issues: that was due to institutional differences, including a deep-rooted shareholder primacy and scepticism towards regulation. However, in 2021, there was a shift in the dialogue: the US Congress introduced the ESG Disclosure Simplification Act; the then-Acting Chair of the SEC, Allison Herren Lee, stated that the SEC would be "working toward a comprehensive ESG disclosure framework" and providing guidance to promote reporting and rulemaking for particular metrics such as board and workforce diversity. The SEC has traditionally focused on requiring companies to report financially material information, but with ESG, it is now aiming to tackle non-financially material information under the concept of double materiality, shifting its rulemaking by requesting the adoption of a disclosure framework on non-financially material topics. It also proposed rules on 21 March 2022 to regulate ESG disclosures, requiring companies to include climate risk-related information in their reports, as well as greenhouse gas emissions data[120].

The move signals a shift towards accepted disclosure standards, such as the establishment of the Task Force on Climate-related Financial Disclosures (TCFD),

[119] Available from: https://www.skadden.com/insights/publications/2021/02/esg-key-trends-in-2020-and-expectations-2021 (accessed on 6 May 23)

[120] Rose A.M. (2021), “A Response to Calls for SEC-mandated ESG Disclosure”, in Washington University Law Review 98

which represents best practice in climate disclosure providing financial market participants with important and decision-useful information, with the US that is likely to join Europe in mandating that financial institutions and companies disclose climate change risks and may even work to harmonize disclosure standards[121].

The UK plans to implement its own green taxonomy based on EU metrics. Other countries are aligning with the new standards, with almost 60% of the top 100 public companies globally supporting the TCFD's recommendations. Many countries, including New Zealand, Japan, Switzerland, South Africa, Brazil, Mexico, and Canada, have committed to making climate-related financial disclosures mandatory, often aligned with the recommendations of the Task Force on TCFD. It is likely that many countries will adopt EU standards to some extent, either by trial and error or directly incorporating them into their own legislation, as the EU's approach to ESG regulation has been influential in shaping global standards[122].

This "internationally recognized" incorporation of disclosure standards is what gives way to the "Brussels Effect".

In the globalized world, it is important to balance regulatory competition and cooperation to avoid challenges that arise from non-harmonized legislation.

In areas where the EU doesn't have direct market access to promote its regulatory power, regulatory cooperation becomes even more important. This is because decision-makers' relationships are shaped not only by socio-economic factors but also by trans-governmental networking[123].

Conflicting regulations between markets may lead to tensions between countries and create regulatory arbitrage for certain companies, which refers to the practice of exploiting gaps or inconsistencies in regulatory frameworks to avoid or bypass unfavourable regulations. Regulatory arbitrage is also a concern in ESG matters, as

[121] Janse K.A., Bradford A. (2021) "European Sustainability Mechanism, Europe Greening the World: The "Brussels effect" on Sustainable Finance"
[122] Alamillos R.R., de Mariz F. (2022) "How Can European Regulation on ESG Impact Business Globally?" in Journal of Risk and Financial Management
[123] Lavenex S. (2014), "The power of functionalist extension: How EU rules travel", in Journal of European Public Policy Vol. 21, (pp. 885–903)

differences in regulations may incentivize issuers to adopt the least burdensome taxonomy. US scholars and industry leaders have raised concerns about ESG regulation and applicability, emphasizing the need for safe harbours to encourage transparency in disclosures and boost dialogue between issuers and investors. They propose that ESG disclosures should not be considered "material" even if required, and there should be no private right to act on them[124].

However, implementing a universal ESG reporting framework that applies to all public companies is not simple due to the distinctive features of ESG reporting, which differentiate it from financial reporting. Challenges include identifying ESG materiality, which will be arbitrary and unsatisfactory to many stakeholders, and supplying accurate and understandable information, which is difficult given the scope of ESG issues and the fact that much of the information is not quantifiable[125].

There is still much room for improvement in regulatory cooperation, and formal agreements between institutions and country members can be effective in achieving the ultimate goal of addressing climate change. Key areas of focus should include analysing the urgent need for collaboration among key players to standardize regulations and prevent greenwashing, protectionism, and regulatory arbitrage, while promoting sustainable growth and prosperity. To achieve the net-zero objectives of the Paris Agreement, regulatory oversight and high-quality third-party auditing will be essential for corporations.

3.2 - A modern interpretation of fiduciary duties

Utilizing someone else's funds for social good. With the growing awareness of ESG issues among companies, investors, and consumers, how can managers reconcile their fiduciary duties with the goal of promoting ESG? Is it possible for ESG to align with their primary responsibility of generating returns for investors?

[124] Katz A., McIntosh. L.A. (2021) "SEC Regulation of ESG Disclosures" in Harvard Law School Forum on Corporate Governance

[125] Aliakbari E., Globerman S. (2023), "The Impracticality of Standardizing ESG Reporting (ESG: Myths and Realities)", Fraser Institute, Canada

It's encouraging to see more fund managers committing to incorporating ESG factors into their investment decisions. However, these managers need to exercise caution due to the traditional "agency problem." As agents for their investors, their personal interests may not perfectly align with the beneficiaries'. Additionally, the information asymmetry between expert managers and inexpert beneficiaries may worsen this problem. So, while the commitment is commendable, it's important for managers to be mindful of these potential conflicts of interest. The legal system has attempted to address this issue by enforcing fiduciary duties.

Fiduciary duty refers to the obligations that fiduciaries have in managing finances on behalf of others. This typically entails fiduciaries taking charge of their clients' assets and making decisions that serve their clients' best interests[126]. The debate on whether corporate fiduciaries are obligated to maximize profit and shareholder value has been rekindled by the widespread adoption of ESG factor investing.

How can ESG considerations be reconciled with traditional fiduciary duties? This presents a challenge for fund managers, who must determine whether ESG goals conflict with the best financial interests of investors, as traditionally defined. It is unclear whether ESG priorities can be reduced to financial metrics and therefore qualify as part of investors' "best interests." Moreover, the manager's personal views on ESG may not align with those of the investors. While some contend that this conflict is non-existent and that ESG considerations are fully compatible with fiduciary duties, others question whether the manager can justify using investors' funds to advance certain ESG causes for personal reasons.

As part of the yearly reporting and evaluation framework in 2019, the PRI requested its signatories to explain their interpretation of their fiduciary duties. The results showed that more than 90% of the respondents acknowledged the importance of ESG issues in their investment procedures as a necessary part of fulfilling their duty towards their clients or beneficiaries. For most, ESG analysis was deemed critical in managing

[126] Available from: https://corporatefinanceinstitute.com/resources/wealth-management/fiduciary-duty/ (accessed on 11 May 2023)

risks or avoiding downside risk, while a smaller number perceived it as a way to identify investment opportunities[127].

It is important to examine how these duties apply to the use of ESG integration in investment decision-making.

The duty of obedience state that a fiduciary must be obedient to the terms establishing the fiduciary's authority[128]. These terms can be found in governing instruments such as trust instruments, pension plans, and charities. Fiduciaries are required to follow any instructions regarding the purposes of the trust, plan, or charity, as well as any specific instructions concerning investment decision-making. Environmental and social issues may also be included in private trust instructions, which fiduciaries must comply with.

The duty of loyalty requires fiduciaries to place the interests of the company and the shareholders before any of their personal interests; it is expected that the trustee exhibits "undivided loyalty" and takes into account solely the interests of the beneficiaries when making decisions, impartially balancing the any conflicting interests of different clients[129]. In the early stages of SRI, there were concerns about whether engaging in any form of SRI would violate the duty of loyalty, as there was little information available on SRI fund performance and SRI index funds were not yet in existence. The Uniform Prudent Investor Act included a warning in its comments, stating that any form of "social investing" that involves sacrificing the interests of trust beneficiaries, such as accepting below-market returns, in favour of pursuing a particular social cause is not consistent with the duty of loyalty[130]. However, recent reports suggest that SRI, particularly ESG integration, does not necessarily involve a cost. While the choice of manager or investment fund may impact returns, the decision to consider ESG information does not always mean accepting below-market returns. In fact, evidence suggests that ESG information may enhance returns, particularly over

[127] PRI (2021), "Fiduciary Duty in 21st Century", Final Report

[128] Atkinson R. (2008), "Obedience as the Foundation of Fiduciary Duty", in Journal of Corporation Law, Vol. 34(1) (pp. 43-98)

[129] Langbein J.H. (2005), "Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?", in The Yale Law Journal, Vol. 114 (pp. 929)

[130] National Conference of Commissioners on Uniform State Laws (1994), "Uniform Prudent Investor Act (UPIA)"

a longer time period. Indeed, fiduciaries may also consider interests beyond financial gains, understanding and incorporating into their decision making the sustainability preferences of beneficiaries and/or clients, whether these preferences are financially material or not: for example, investing to reduce the impact of climate change could be in the best interests of all beneficiaries.

The duty of care or prudence is the fiduciary's duty to manage assets with "reasonable care, skill and caution": it encompasses the prudent investor standard which requires fiduciaries to act prudently and consider the interests of the beneficiaries and the fund's purposes when making investment decisions[131]. In 2015, the Department of Labor (DOL) issued an Interpretive Bulletin recognizing the potential for ESG integration to generate superior financial outcomes compared to other investment strategies and encouraging prudent investors to factor in ESG considerations[132]. If ESG factors are not considered, there may be uncompensated risks in a portfolio due to system-level issues such as climate change and political unrest. Additionally, as the advantages of taking a longer-term perspective in investment decision-making become clearer, a prudent investor will aim to safeguard value by considering more than just short-term returns. The State of Delaware amended its prudent investor statute in 2018 to allow for fiduciaries to consider the personal values of beneficiaries, including sustainable investing strategies. This reflects the overlap between the duty to act as a prudent investor and the duty of loyalty: the way in which a fiduciary invests will depend on whether the term "best interests" encompasses non-financial interests, as this will impact the fiduciary's obligation to act in the beneficiary's best interests[133]. To sum up, it is expected that fiduciaries invest in a manner that aligns with the standard practices of an "ordinary prudent person": this involves integrating financially material ESG factors into their investment decision-making process in accordance with the

[131] Bradley M., Schipani C.A. (1989), "The Relevance of the Duty of Care Standard in Corporate Governance", in Iowa Law Review, Vol. 75(1)

[132] DOL (2015), "Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments" in Federal Register, Vol. 80, No. 206

[133] Susan N.G. (2019), "Best Interests in the Long Term: Fiduciary Duties and ESG Integration", in University of Colorado Law Review 90, No. 3 (pp. 731-802)

obligation's timeframe, being an active owner promoting high ESG performance standards in the companies or other entities in which they are invested, and supporting the financial system's stability and resilience.

Finally, the duty of impartiality applies to all situations involving fiduciaries, but it becomes especially significant when funds are being held for several generations; fiduciaries are obligated to act with impartiality towards multiple generations of beneficiaries under the duty of impartiality[134]. Thus, the duty does not necessitate that fiduciaries treat each beneficiary with equal treatment. Rather, it requires the trustee to take into account the distinct needs of all current and future beneficiaries depending on the trust's or plan's purpose. It may be argued that fiduciaries can prioritize short-term returns repeatedly, assuming each generation benefits from successive short time horizons. However, investments in each short-term period have an impact on the next. According to Jim Hawley and Jon Lukomnik, the long-term is not just a sum of short-term intervals that are unrelated to one another. Rather, it is the connections between past, present, and future events[135]. If long-term systemic risks have implications for investors, then fiduciaries who disregard essential long-term information may violate their duty to act as prudent investors. Additionally, if paying attention to sustainability and corporate governance concerns can enhance a company's long-term value, making investment decisions based only on quarter-to-quarter results will not suffice. A fiduciary who is concerned about the duty of impartiality must consider long-term value.

To conclude, it should be emphasized that fiduciary duties do not preclude ESG issues: many institutional investors and asset managers are increasingly considering ESG factors in their investment decision-making process and, as we have seen before, in some jurisdictions like EU, there are legal and regulatory requirements that explicitly require companies and investment managers to consider ESG factors in their decision-

[134] Nir S. (2020), “One duty to all: the fiduciary duty of impartiality and stockholders' conflict of interest”, in Hastings Bus. LJ, Vol. 16

[135] Hawley J., Johnson K., Waitzer E. (2011), “Reclaiming Fiduciary Duty Balance” in Rotman International Journal of Pension Management, Vol. 4(2)

making. There is growing recognition that considering ESG factors can help enhance long-term financial performance and manage risks.

3.3 - Fiduciary duty and human rights: balancing autonomy and obligations

Should a corporate fiduciary who is loyal to the company have the autonomy to make choices related to human rights that prioritize the interests of non-shareholders, or are they obligated to address human rights concerns in ways that benefit the stockholders? Human rights, as normative values, place constraints on the fiduciary loyalty expected of corporate decision makers. This external constraint means that corporate decision-making is influenced and limited by the value of human rights, independent of the results of economic cost-benefit analyses regarding business risk and return on investment. It is important to note that the value of human rights is not subordinate to the value of corporate loyalty. Rather, human rights have equal normative status to corporate loyalty as a duty or value that a corporate fiduciary must honour. The cultural allegiance to a company is expected of every employee and plays a critical role in realizing the company's goals. On the other hand, the fiduciary duty of loyalty is crucial for the structural and organizational coherence of a corporate entity, but it is legally and ontologically distinct from the allegiance expected of an agent to a principal.

Corporate directors are expected to follow the fiduciary mandates of the jurisdiction in which the corporation is domiciled, and their legal duties may vary depending on the geographical division where the company is based and the applicable law[136]. However, the global parent company may establish firm-wide policies that all subsidiary entities must follow, including policies to respect human rights.

The parent company also sets the overall culture of the organization, and directors and managers throughout the group are expected to conform to the norms and values that come from the top. The parent company can use incentives, contractual obligations, and global training programs to instil such allegiance among its personnel. Thus,

[136] Vagts D.F., Koh H., Dodge W.S., Buxbaum H. (2014), "Transnational Business Problems", in University Casebook Series, 5th edition

managerial decision-making at all levels within the corporate group structure is influenced by a mix of intra-firm norms and values (such as cultural allegiance, policies, and business culture), legal obligations (like fiduciary duties and contractual commitments), industry standards, voluntary codes, and expressions of "soft law." The corporate fiduciary mandate exists within this mix of norms, and the range of the fiduciary mandate is limited by values that exist within the negative space outside of positive law. This complex mix of norms, values, rules, and laws in positive and negative space shapes managerial decision-making on matters related to human rights at various levels of the firm[137].

3.4 - ESG rating: a system that is poorly shared and transparent

ESG encompasses a broad and diverse range of factors, and ESG ratings firms are becoming more critical in the investment landscape as they evaluate companies on numerous ESG criteria. However, the shortage of reliable data on which ESG ratings are based impedes broader acceptance of ESG strategies. Additionally, the methodologies employed by ESG data providers vary, which can result in vastly different portfolio compositions.

The ESG landscape is complex and features a multitude of ratings providers who offer a wide range of data. These providers can specialize in specific ESG metrics, such as carbon emissions or gender diversity, or rate companies based on hundreds of ESG-related factors. However, it can be difficult to navigate the different options and find the most appropriate data provider since there is no single comprehensive directory available. Some articles have attempted to organize the available information, but the fast-paced growth of the ESG data space has made them quickly outdated[138].

The demand for ESG information has increased significantly in recent years. This is driven by asset owners, institutional investors, companies, regulators, and other

[137] Rogge M. (2022), “Humanity constrains loyalty: Fiduciary duty, human rights, and the corporate decision maker”, in Fordham Journal of Corporate and Financial Law, Vol. 26, No. 1 (pp. 147-182)
[138] Dimson E., Marsh P., Staunton M. (2020), “Divergent ESG ratings” in The Journal of Portfolio Management

stakeholders. However, the ability of suppliers to provide the required depth, detail, and accuracy of data is limited due to the difficulty in measuring ESG factors and determining their impact.

The concept of ESG ratings is aimed at evaluating the quality of a company's ESG practices. However, the definition of ESG quality varies depending on different perspectives. There are two main views on ESG, which seem to work in opposite directions[139]:

- One perspective suggests that ESG measures the extent to which a company positively impacts its stakeholders, including its employees, suppliers, customers, the local community, and the environment. By this definition, a company can improve its ESG profile by either discontinuing activities that negatively affect its stakeholders or enhancing business practices to benefit these groups. The cost of such an investment, at least in the short term, is borne by the shareholders, while the long-term financial impact on the company is uncertain or not specified. Most individual investors are likely to associate ESG quality with this "doing good" perspective.
- The other view is that ESG assesses the impact that societal and environmental factors have on the company, and that these factors are financially relevant. According to this definition, an ESG framework provides a set of risk factors that the company can address through strategic planning, targeted investment, or changes in operating activities. Although addressing ESG risk factors may be costly in the short run, it is expected to yield a long-term financial benefit to the corporation and its shareholders. This perspective, which focuses on the impact of environmental and social risks on financial performance, is the one mainly adopted by ESG ratings providers.

The ESG ratings industry consists of many ratings agencies and data providers, including MSCI, ISS ESG, Sustainalytics, Refinitiv, and FTSE Russell. Other well-

[139] Larcker D.F., Pomorski L., Tayan B., Watts E.M. (2022), "ESG ratings: a compass without direction", in Rock Center for Corporate Governance at Stanford University Working Paper Forthcoming, August

known firms in the ESG ratings industry include S&P Global, Vigeo Eiris, HIP, and TruValue Labs. ESG indices have expanded considerably since the creation of the first one in 1990, which was called the Domini 400 Social Index (now known as the MSCI KLD 400 Social Index). Presently, MSCI Inc., the leading provider ESG Indexes globally, offers more than 1,500 equity and fixed income ESG Indexes[140]. These Indexes are designed to help institutional investors benchmark their ESG investment performance more efficiently and manage, measure, and report on their ESG mandates. ESG ratings firms have varying approaches in providing insights into ESG quality, as seen in their stated objectives. While many providers focus on reducing investment risk, others aim to predict returns, measure environmental or social impact, or provide a screen for ESG selection. The accuracy of these claims can be tested by correlating ESG ratings with subsequent stock or bond price changes. ESG ratings are reported using letter or numeric scales and can be industry-adjusted or absolute. Industry-adjusted ratings allow for comparison within the same industry, while absolute ratings can be used for comparison across industries but may be influenced by a company's line of business.

Some ratings providers, such as MSCI, employ a 7-point scale that ranges from AAA to CCC, similar to those utilized by major credit-rating agencies, while others, such as ISS, adopt a 12-point scale that ranges from A+ to D-, similar to that of an education system. Another common approach is to present scores as percentiles, which range from 1 to 100 and may reflect high ESG quality (positive) or high ESG risk (negative). The methodologies and reliability of ESG ratings are often questioned by practitioners who admit to having a limited understanding of them. The Alternative Investment Management Association (AIMA), a global representative of such firms, acknowledges that its members “have faced difficulties in comprehending and validating the approaches adopted by various ratings providers”.[141] Similarly, the

[140] Available from: https://www.msci.com/our-solutions/indexes/esg-indexes (accessed on 11 May 2023)
[141] AIMA (2020) “AIMA Comments on the European Commission’s Targeted Consultation on the Functioning of the ESG Ratings Market in the European Union and on the Consideration of ESG factors in Credit Ratings”, June

European Securities and Market Authority regards the ESG ratings market as "unseasoned" due to its configuration and diversity of methodologies[142].

ESG ratings show systemic patterns. One such pattern pertains to company size, where larger companies generally receive higher ratings than smaller ones. This may be due to larger firms having more resources to invest in ESG initiatives, or because they have better disclosure of ESG data. Another pattern is industry-related, where certain industries such as banks and wireless communications tend to have higher average scores than others like tobacco and gaming. It's unclear whether this is due to actual differences in ESG quality or methodological choices and input variables underlying ESG rating models. A third pattern is country-related, with European companies having higher average ESG scores than their U.S. counterparts, possibly due to political and regulatory differences. Additionally, firms in emerging markets generally have lower ratings than those in developed economies[143].

According to research, ESG ratings tend to increase over time, which is referred to as an "upward drift." A study conducted by D.E. Shaw demonstrated an 18% improvement in aggregate ESG scores for all Russell 1000 companies between January 2015 and December 2021. Structural changes, such as changes in the index composition and weightings assigned to components in the MSCI model, account for 6 percentage points of this improvement. More disclosure by companies also leads to subsequent upgrades. Even after adjusting for these structural changes, an aggregate 12 adjusted improvement in MSCI ratings is observed, which is referred to as "grade inflation." The reason for this improvement is not explained[144].

Several studies suggest that ESG ratings have low associations with environmental and social outcomes. It has been demonstrated that companies in ESG portfolios have worse compliance records with labour and environmental laws than those in non-ESG

---

[142] European Securities and Markets Authority (2022), "Outcome of ESMA Call for Evidence on Market Characteristics of ESG Rating and Data Providers in the EU", June

[143] Akgun O.T., Mudge T.J., Townsend B. (2021), "How Company Size Bias in ESG Scores Impacts the Small Cap Investor" in The Journal of Impact and ESG Investing

[144] D.E. Shaw (2022), "Keep the Change: Analyzing the Increase in ESG Ratings for U.S. Equities", April

portfolios, and that joining the Principles for Responsible Investment is associated with worse ESG ratings[145].

Although passive investment products are often thought of as transparent, their actual implementation of ESG is often opaque. Many of these products depend on a single ESG rating provider, and their rating methodologies are difficult for both professional and retail investors to understand. These methodologies typically focus on superficial policies and disclosures that may not be related to investment performance and may be based on historical negative events that have little predictive value.

In conclusion, the reliability of ESG ratings as a predictor of investment risk or return, as well as improvements in stakeholder outcomes, is still uncertain. This raises questions about the validity of relying on ESG ratings to attract investment. Additionally, there is a need to consider the challenges of measuring a broad concept like ESG and the potential benefits and drawbacks of expansive corporate disclosure. Given the substantial research evidence that ESG ratings are unreliable in predicting outcomes, it is important to explore whether ESG ratings should be subject to similar regulation requirements as major credit rating agencies to improve market confidence in their quality. Better client reporting, improved transparency around benchmarks and clear voting practice are needed.

3.5 - ESG on trial: the disconnect between ESG scores and socially responsible behaviour and low level of protection from the current crisis

Numerous investors and fund managers channel their investments towards companies with high ESG ratings, in an effort to make a positive impact. Do ESG ratings fulfil their promise? Do businesses with high ESG rankings truly prioritize environmental concerns, demonstrate selectivity in the societies they engage with, and focus on countries with good corporate governance? In other words, is ESG truly effective?

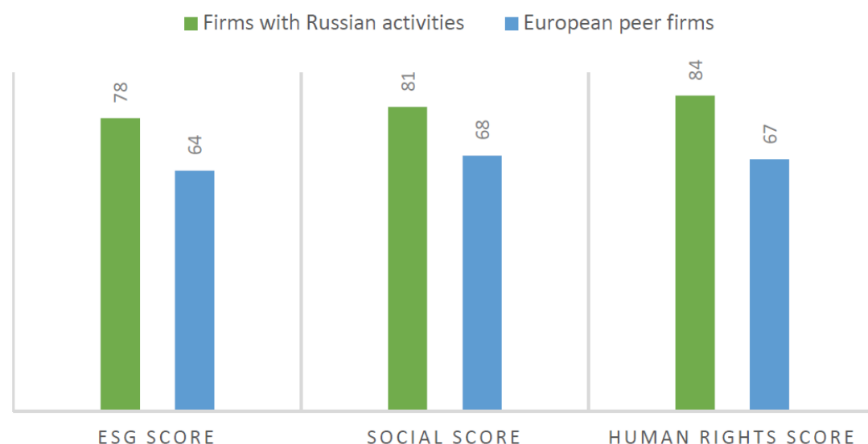
[145] Raghunandan A., Rajgopal S. (2022), “Do ESG Funds Make Stakeholder-Friendly Investments?”, in Review of Accounting Studies

Recently, ESG rating agencies have been accused of failing to adequately consider the risks inherent in the investment portfolios of firms, many of which remained heavily exposed to Russia even after the outbreak of the current war. A Harvard study has pointed out that there is an ESG rating gap in favour of these firms compared to comparable firms that have severed relations with Russia, reporting a rather bizarre GAP on the "S" pillar and the Human Rights component.

They examined the ESG scores and response to the Russian invasion of Ukraine among all European firms with a substantial presence in Russia, which are defined as companies with Russian subsidiaries that generate more than USD 100 million in sales and have more than USD 100 million in total assets. They focused on Russian subsidiaries of large European firms that represent significant investments of economically important firms that are unambiguously identifiable from standard sources.

The results of this research are striking: the average ESG scores of European firms with significant activities in Russia are significantly higher than the scores of similar-sized non-financial European companies. The average scores of the Russia-invested group on the "S" and human rights sub-dimensions are also higher. This indicates that European companies with substantial subsidiary operations in Russia are, on average, more socially responsible than comparable European firms with zero or limited Russian operations.

Graph 8: Mean ESG scores of European firms with Russian activities and their peers (Hendrikse, 2022)[146]



[146] Hendrikse J. (2022), "The False Promise of ESG" in Harvard Law School Forum on Corporate Governance, March

The study shows that there is no statistical association between ESG scores and the timeliness of a meaningful response to the Russian invasion, indicating that higher ESG scores do not necessarily translate to more socially responsible behaviour in times of crisis.

Another point of controversy concerns ESG funds. In fact, it was expected that ESG funds would provide a higher level of protection from the current crisis, which instead generated losses even among sustainable investment funds that had remained exposed to both Russian government securities and Russian oil and gas companies. This controversy was raised by an article that came out in March 2022 in Bloomberg, which refers to USD 8.3 billion losses attributable to ESG funds and questions their effectiveness in selecting securities in portfolios[147].

Another issue that is debated by analysts is whether sustainable finance should continue to exclude the armaments sector, given the risks posed to democracies and freedom[148]. The conflict in Ukraine has reignited the debate over whether weapons manufacturers' stocks can be considered ESG investments. Some analysts argue that weapons makers' ESG credentials should be re-evaluated, while others assert that defence is necessary to maintain peace and stability, making it an enterprise that facilitates ESG. In January, Swedish financial group SEB reversed its weapons exclusion policy to permit six of its funds to invest in weapons manufacturers due to growing geopolitical tensions, including Russia's invasion of Ukraine. The EU's revised social taxonomy could potentially include arms manufacturers as part of the ESG lexicon. While politicians debate the ethical value of weapons manufacturing, according to "As You Sow's" database, a shareholder advocacy group, over half (52%) of sustainable funds classified by Morningstar currently have an exposure worth USD 7.3bn to military weapons,

[147] Available from: https://www.bloomberg.com/news/articles/2022-03-08/esg-funds-had-8-3-billion-in-russia-assets-right-before-the-war#xj4y7vzkg (accessed on 5 May 2023)

[148] Ahmed A. (2010), "Global financial crisis: an Islamic finance perspective" in International Journal of Islamic and Middle Eastern Finance and Management.

indicating that many ESG funds hold stocks of companies connected to the weapons industry[149].

To sum up, there are several highly relevant issues. The most significant is that ESG ratings show weaknesses inherent in a system that is not widely shared or transparent. The issue of war makes these gaps even more apparent, especially in the S and G pillars, which are populated by indicators that often diverge between agencies. It is therefore necessary to bring order to ESG ratings through regulatory interventions, ideally shared among the authorities of the major markets.

As for the issue of ESG funds, it proves to be quite modest if we consider the numbers because only 300 out of 4,300 funds identified by Bloomberg as sustainable have been exposed to controversial investments (about 6%). However, when considering the reported losses (over 3 billion) on management assets (2,300 billion), the exposure is 0.4%. Therefore, there is a relevant pitfall if ESG funds that passively mimic an index (in this case they imitated an emerging market index) can effectively make a selection: in this case, the losses are few, but it is because the Russian economy has a low weight compared to the overall index. As for the issue of excluding/including certain systems and investments, it is necessary to say that sustainable finance is not equivalent to ethical finance (which is often based on a structure of values, religiously inspired). Sustainable finance does not start from an ideological basis but from a practical need to address the risks of the climate transition in a context of significant social changes[150]. If we start from this assumption, it is understandable why the exclusion criterion adopted by ESG criteria concerns producers of weapons but only those that are prohibited according to international treaties or conventions (anti-personnel mines, cluster bombs). As we have seen in the previous chapter, this ESG integration criterion adopted by almost 64% of investors, while 45% of ESG investors adopt an exclusion system that extends to the entire arms sector. There is no surprise in discovering that some investors, while using an ESG filter, do not completely exclude this sector from

[149] Available from: https://capitalmonitor.ai/strategy/responsilbe/how-exposed-are-esg-funds-to-weapons/ (accessed on 8 May 2023)

[150] Gutterman A.S. (2021), “Sustainable finance and impact investing), in Business Expert Press

the investable universe. The same issue arises, for example, in the oil and gas sector. Not all ESG investors have divested from this sector, but they adopt different criteria from mere exclusion, such as best-in-class criteria.
So basically, the weaknesses of ESG ratings, greenwashing by some funds that do not adopt efficient solutions criteria, and the confusion between sustainable finance and ethical finance that risks fuelling false expectations, are all elements that need to be improved to achieve a clearer path towards sustainability.

3.6 - How should companies adjust

ESG rating and data providers such as MSCI and Sustainalytics publicly disclose the overall scores given to the companies they analyse. This increased transparency allows market participants to scrutinize their methodology, specifically the differences in how ESG factors are deemed material across firms, how ESG factors are measured, the weight assigned to ESG factors, and the sources utilized in the assessment.
Academic research has highlighted the inconsistency among ESG data and ratings providers. Berg et al. (2019) identify three reasons for the divergence in ESG ratings: variations in category scope, differences in category measurement, and disparities in category weighting.
Scope divergence in ESG ratings occurs when companies are not assessed on the same set of ESG factors, leading to different overall scores for rated companies. This may be more pronounced for companies with diversified business operations and can be attributed to differences in industry classification systems used by ESG rating agencies. Some companies may also be rated on topics or indicators that are not relevant to their business.
MIT's research found that Measurement Divergence is the most significant contributor to overall score divergence amongst ESG ratings providers. This occurs when different ratings providers use different indicators to assess the same set of ESG issues, leading to different assessments. For example, using employee turnover or the number of

labour-related litigations to evaluate human capital management could result in different assessments. Additionally, different ratings providers may treat the same issue differently under different ESG pillars.
Weighting Divergence refers to the differences in the importance given to certain ESG factors by different ratings providers. It reflects diverging views on the materiality of these factors and leads to different overall scores for rated companies. Weighting divergence can be addressed by focusing on the overall impact of a company's actions, rather than just input-based indicators. This is because output-based indicators, which are outside of management's control, are more useful in measuring a company's sustainability[151].
The divergence in ESG ratings is not seen as problematic by all investors, but rather as the added value of each ESG data and ratings provider. The consensus seems to be that there is value in having different ESG ratings providers as they all bring different perspectives and answer different questions[152]. However, it is important for companies to understand the underlying data captured, weightings, and assumptions behind each ESG ratings provider's methodologies, as these ratings are used to select constituents of ESG indices, which directs investment towards the selected companies.
ESG data and ratings providers are not currently regulated in the same way as credit rating agencies and financial intermediaries. However, in December 2020, French and Dutch financial authorities proposed a European regulatory framework for "sustainability-related service providers" that includes various requirements for ESG rating providers, including transparency on methodologies and management of conflicts of interest[153].
The Global Reporting Initiative (GRI) and the Sustainability Accounting Standards Board (SASB) have different approaches to materiality in ESG reporting. GRI takes

[151] Berg F., Kolbel J.F., Rigobon R. (2019) “Aggregate Confusion: The Divergence of ESG Ratings”, in Forthcoming Review of Finance
[152] Hirai A., Brad A. (2021), “Managing ESG Data and Rating Risk”, in Harvard Law School Forum on Corporate Governance
[153] AMF (2020), “Position Paper: Call for a European Regulation for the provision of ESG data, ratings, and related services”

an outward-looking approach and requests companies to disclose material ESG topics that reflect their significant economic, environmental, and social impacts on stakeholders. On the other hand, SASB has developed a materiality map outlining material ESG topics for each industry, with a focus on factors that could affect financial performance and enterprise value of the reporting company, thereby influencing investment or lending decisions. The outward-impact and inward-impact approaches are not mutually exclusive, but instead, they complement each other and are in line with the EU's Non-Financial Reporting Directive's (NFRD) "double materiality" concept. The concept of materiality should be dynamic and evolve over time, with companies continuously monitoring changing stakeholder expectations and adjusting priorities when necessary. ESG ratings providers should engage with their clients when changing their methodologies to address issues of ratings volatility and additional transparency is critical.

The way companies organize their data collection and reporting efforts is increasingly important as the demand for ESG practices and disclosures rises. ESG ratings inequality is a concern because larger companies tend to have better ESG practices and disclosures, which can disadvantage smaller companies. ESG ratings providers are expanding their coverage to include smaller companies and emerging markets, which could further widen the inequality. To address this, some ratings providers use a different rating framework for smaller companies to account for the difference in reporting quality. Companies can streamline their sustainability reporting by creating a centralized team to organize data, prioritizing reporting on information material to shareholders, and identifying initiatives supported by investors. Additionally, they can prioritize their focus on ESG ratings and data providers used by their top shareholders and determining the constituents of main ESG indices.

To engage with stakeholders, including investors and proxy advisors, companies should use sustainability reporting. They can achieve this by creating a dedicated sustainability section on their website and updating it regularly with ESG data and policies. Additionally, companies should directly engage with investors by showcasing

their sustainability efforts through ESG roadshows, webinars, and conferences. This allows them to explain their sustainability strategy in detail and address investor concerns. Direct engagement is crucial as investors may not fully understand a company's ESG strategy, risk management, and governance through corporate disclosures and third-party ESG ratings alone.

ESG ratings and data providers are increasingly important for investors, especially due to the EU's Sustainable Finance Disclosure Regulation. Companies should prioritize engagement with relevant ESG ratings providers to identify ways to improve ESG practices and disclosures for higher ratings.

3.7 - The Green Financing

The world requires the optimal use of capital to improve living standards and bring prosperity to society, and it is essential for the financial industry to understand how Sustainable Development Goals can reshape the global economy. To achieve this, new financial instruments must be introduced to provide capital for environmentally friendly projects.

Entities that can issue securities, including governments, companies, corporations, not-for-profit organizations, and other institutions, can issue green bonds to finance environmentally sustainable and socially responsible projects. The issuance of green bonds helps to attract investors who are interested in supporting these types of projects. It is important to note that the issuance of green bonds is regulated and subject to specific rules and standards established by organizations such as the Institute of International Finance (IIF). A wide range of sustainable and environmental projects can be financed using green bonds, such as renewable energy, energy efficiency, conservation of terrestrial and aquatic biodiversity, pollution prevention and control, green infrastructure, and sustainable development ... The objective is to use the proceeds raised from green bond issuance to support projects with a positive impact on the environment and society as a whole. Green bonds function similarly to

conventional bonds, with entities issuing and selling them to investors to finance sustainable and environmental projects. However, green bonds differ in that since they are linked to specific projects with a positive environmental and social impact, subject to greater transparency and accountability, and often certified and evaluated by independent bodies to ensure their sustainability. Investors may choose to invest in green bonds as a way of supporting these projects while also receiving financial returns[154].

There are diverse and wide-ranging key themes in Green, Social & Sustainability Bond Markets, reflecting the growing interest from investors for sustainable investment opportunities.

One of the most significant themes is the growing investor demand for socially responsible investments. This asset class has seen a surge in popularity in recent years, with ESG analysis being rapidly adopted by mainstream investors. This trend has led to a strong increase in demand for Green, Social and Sustainability bonds: as investors get more knowledge about ESG objectives, the demand for these bonds increases[155].

Another important theme is the growth in COVID-19 related bonds. In response to the pandemic, we have seen a sharp increase in bond issuances linked to funding COVID-19 response and relief packages.

UN SDG and KPI-Linked Bonds are also emerging as an important trend. Enel made history in 2019 by issuing the first benchmark transaction in the bond markets, offering a coupon step-up in the event that they fail to achieve their SDG-linked target[156]. This innovative approach to sustainable finance has garnered widespread interest from markets and investors. That innovative structure allows issuers to raise funds without necessarily allocating them to specific green or sustainability projects. Probably more issuers will adopt this structure in the future, as it offers greater flexibility while still promoting sustainable finance. By offering a coupon step-up, issuers are incentivized

[154] Available from: https://aplanet.org/resources/green-bonds/ (accessed on 12 May 2023)

[155] Agliardi E., Agliardi R. (2019), “Financing environmentally-sustainable projects with green bonds” in Journal of Environment and Development Economics, Vol. 24(6) (pp. 608-623)

[156] Available from https://www.enel.com/company/stories/articles/2023/02/new-framework-sustainable-finance-group (accessed on 12 May 2023)

to meet their SDG targets and demonstrate their commitment to sustainability, which in turn can attract socially responsible investors. Overall, this development is a positive step towards promoting sustainable finance and encouraging companies to take a more proactive approach towards achieving their environmental and social goals.

Another important theme is related to the European Commission release of the EU Green Bond Standard[157], a report which is expected to be adopted into regulation, providing issuers and investors with clearer definitions of what are sustainable economic activities.

Companies with low ESG scores or poor ESG practices are facing challenges in achieving favourable pricing during primary market executions, attracting new investors, retaining existing investors, and maintaining secondary spread performance. Then, due to growing investor demand for socially responsible investments, green, social, and sustainability bonds are becoming an increasingly attractive asset class. As a result, these bonds often receive higher oversubscription rates compared to regular bonds, leading to better pricing and lower new issue concessions (even if the pricing advantage is difficult to harness or quantify)[158].

Green bonds have become increasingly popular as a type of fixed-income security in recent times. However, there is disagreement among people about the definition of this financial instrument. According to the Green Bond Principles (GBP) established in 2018, a green bond is a bond where the proceeds are used exclusively to finance or re-finance eligible green projects[159]. On the other hand, Bloomberg defines green bonds as financial securities that fund projects aimed at reducing greenhouse gas emissions and mitigating the adverse effects of industrialization globally. In theory, green bond proceeds are utilized for green technologies, also known as green projects, which are primarily in their early stages and not commercially viable yet. Unlike conventional (brown) bonds, which are used to finance traditional projects with more commercial

[157] Available from: https://finance.ec.europa.eu/sustainable-finance/tools-and-standards/european-green-bond-standard_en (accessed on 12 May 2023)
[158] CITI (2021), "ESG: increasingly an imperative", April report
[159] ICMA (2021), "Green Bond Principles: Voluntary Process Guidelines for Issuing Green Bonds", June

viability, investment in green projects is risky, and returns are uncertain. As a result, there is a significant gap between the financing needs and availability of finance for green projects. Green bonds can help bridge this gap and reduce ecological deterioration by providing financing for green projects[160].

Issuing green bonds offers a multitude of benefits for companies:

- Firstly, it can help raise external awareness and promote positive public relations: by issuing green bonds, a company can show its commitment to sustainability and attract investors who share the same values.
- It can raise internal awareness and encourage sustainable operations within the company: this can lead to reduced environmental impact and increased efficiency.
- It can align funding with overall sustainability strategies and goals, helping to ensure that a company's financial decisions are in line with its environmental and social values.
- Green bonds also promote ESG policy making and encourage companies to consider environmental, social, and governance factors in their decision-making processes.
- By issuing green bonds, companies can attract a more diverse group of investors who align with their sustainability goals. This can lead to investor diversification and alignment with the growing mainstream investor focus in this sector.
- Furthermore, green bonds can result in lower new issue concessions due to increased investor interest.
- Finally, there is no or limited additional bond documentation required for green bond issuances, which can save time and resources for companies.

In order to achieve the United Nations' Sustainable Development Goals, it is crucial to have easy access to capital for minor carbon emission projects. However, there is debate over whether funds raised through green bonds are actually being used for

[160] Bhutta U.S., Farrukh M., Raza A., Iqbal M.K. (2022), “Green bonds for sustainable development: Review of literature on development and impact of green bonds”, in Journal of Technological Forecasting and Social Change, Vol. 175, February

climate-friendly projects or if they are just a form of "greenwashing" for the issuer. Other secondary risks refer to the additional cost and effort required for second-party opinion, assurance, or verification, and the complexity of commitments to allocation and impact reporting, which may involve multi-party coordination.

Research conducted by Wang et al. (2020) aimed to investigate the factors that contribute to the premium associated with green bonds, using data from the Chinese capital market between 2016 and 2019. To achieve this, they compared the characteristics of synthetic conventional bonds with those of green bonds. The findings of their analysis indicate that certain features of green bond issuers, such as lower ownership concentration, positive social reputation, and greater participation of long-term investors in firm ownership, are associated with a higher premium, the so called “Greenium”[161].

As a debt instrument designed specifically for environmentally friendly projects, green bonds are an alternative to conventional bonds; in general, their issuance has a favourable effect on companies by aiding environmental progress, encouraging corporate social responsibility and value creation, and to some extent, attracting investors[162].

Macroeconomic indicators and regulatory support are critical for the development of the green bond market, and institutional sponsorship is necessary to promote environment-friendly projects and secure financing. While green bonds have the potential to be a source of financing for environmentally friendly projects, the recent pandemic has created challenges for funding such projects. Therefore, more studies are needed to investigate the future of green investments in the post-COVID-19 era. A comprehensive strategy is required to cope with environmental challenges, focusing on developing and promoting instruments to finance such projects.

---

[161] Wang J., Chen X., Li X., Yu J., Zhong R. (2020), “The market reaction to green bond issuance: evidence from China”, in The Pacific-Basin Finance Journal, Vol. 60, Article 101294

[162] Zhou X., Cui Y., (2019), “Green Bonds, Corporate Performance, and Corporate Social Responsibility” in Sustainability, Vol. 11(23)

CONCLUSIONS

We have seen how the deleterious effects of climate change have emphasized the imperative need for pre-emptive measures to alleviate its repercussions. These measures are clearly outlined in various international and regional policy initiatives. For instance, the United Nations' 2030 Agenda for Sustainable Development and the European Green Deal discussed by the European Commission are comprehensive policy initiatives aimed at prioritizing environmental protection and promoting sustainable practices. Moreover, the Sustainable Finance Action Plan introduces measures to promote financing sustainable growth and integrate sustainability considerations into financial decision-making.

The impact of these programmatic actions on companies is discussed, including the need for them to align their business strategies with sustainability objectives and disclose relevant information on their sustainability performance.

The history and theories of CSR have been explored, highlighting the shift from the sole focus on maximizing profits to the recognition of broader social responsibilities, with an overall increasing significance of sustainability and CSR in the business world. Companies are now expected to prioritize sustainable approaches, align with international goals and frameworks, and integrate sustainability into their strategies. Failure to do so may result in financial penalties and the loss of government contracts and incentives.

Various aspects related to sustainable and responsible investments (SRIs) have been discussed, which encompass investments in business activities with positive social and environmental impacts, taking into account factors beyond financial performance. Sustainable finance requires a shift away from the conventional approach, which focuses solely on financial gain and treats the financial sector as detached from the environment and society. Overcoming obstacles like short-termism and lobbying against change is crucial for the transition to sustainable finance.

The phenomenon of greenwashing, where companies engage in deceptive practices regarding their environmental performance, has emerged alongside the rise of green markets. Policymakers need to address greenwashing and implement measures globally to hold firms accountable for misleading actions, considering specific measures tailored to different activities.

ESG investing has evolved and gained acceptance among major institutional investors and regulators. The actions of influential entities like BlackRock and Norway's sovereign wealth fund demonstrate the growing perspective on ESG over the past decade. ESG performance has a significant impact on corporate value, with companies demonstrating strong ESG profiles being more competitive, resilient, and attractive to investors. Integrating ESG factors into operations and strategy can also lead to better business performance and financial outcomes. Furthermore, ESG issues have become critical in M&A transactions, and companies that prioritize ESG concerns are better positioned to capture value and succeed, with investors willing to pay premiums for targets with strong sustainability stories. ESG-focused deal-making is expected to increase as a result of various factors, including the rise in capital dedicated to ESG, ongoing investor and regulatory pressure to disclose ESG performance and set targets, and advancements in decision-useful ESG data and analytics.

Europe has taken a leading role in ESG regulation, implementing stringent directives on disclosure, accountability, and investment activities. The EU's regulatory power and cooperation are influencing businesses globally and promoting sustainable growth while preventing greenwashing and regulatory arbitrage.

The disclosure of climate-related information brings various advantages to the reporting company itself, including better risk management, more knowledgeable decision-making, and improved strategic planning. It also enlarges the investor base to encompass a more diverse range of investors, potentially decreasing the cost of capital.

The "Brussels Effect" phenomenon is observed in Europe, where civil society and corporations have led the way in promoting ESG, eventually leading to government action. ESG development is therefore accompanied by an increase in regulations, both

within and outside the EU, among individual investors and institutional ones. In general, the involvement of corporations in addressing climate change is increasingly demanded by shareholders and investors, and meaningful action should be taken to standardize regulations.

The integration of ESG considerations in investment decision-making presents a challenge for fund managers as they navigate potential conflicts of interest with their fiduciary duties. However, ESG integration does not necessarily involve a cost, and evidence suggests that it may enhance returns, particularly over a longer time period. The duty of loyalty, for example, requires fiduciaries to place the interests of the company and the shareholders before any of their personal interests, but recent changes in legislation suggest that fiduciaries may consider interests beyond financial gains. Ultimately, while there may be challenges in reconciling ESG considerations with traditional fiduciary duties, there are opportunities for fiduciaries to incorporate ESG factors into their investment strategies in a way that benefits both their clients and society as a whole. The fiduciary duty of corporate decision-makers is influenced and limited by the normative value of human rights. This external constraint means that human rights have equal normative status to corporate loyalty as a duty or value that a corporate fiduciary must honour.

It has come to the attention of various stakeholders that there exists a legitimate concern regarding the inherent deficiencies of the ESG rating system of companies; there is mounting evidence that points towards the inadequacy and unreliability of the current system in accurately measuring a company's ESG performance. Such a situation has the potential to undermine the credibility of ESG ratings, which could impede the growth of sustainable investing and a broader acceptance of ESG strategies. The reliability of ESG ratings as predictors of investment risk or return, as well as improvements in stakeholder outcomes, remains uncertain. ESG ratings show systemic patterns based on company size, industry, and country, but it is unclear whether these patterns reflect actual differences in ESG quality or methodological choices. The

concept of ESG quality has two contrasting perspectives, and ESG ratings agencies have different approaches in providing insights.

Given these challenges, there is a need for standardization, transparency, and regulation in the ESG ratings industry to improve market confidence and enhance the effectiveness of ESG strategies, which has been recently questioned in the context of the Russian invasion of Ukraine.

It has been found that the ESG scores of European firms with substantial operations in Russia are higher than similar firms without such operations, indicating that higher ESG scores do not necessarily translate to more socially responsible behaviour in times of crisis. The controversy over ESG funds' effectiveness in selecting securities in portfolios and whether to exclude the armaments sector from sustainable finance is also debated. It is important to underline that sustainable finance is not equivalent to ethical finance and must address the risks of the climate transition in a context of significant social changes. Therefore, different investors adopt different criteria for exclusion or inclusion, such as best-in-class criteria, and not all ESG investors divest from the armaments or oil and gas sectors.

It is necessary for companies to understand the underlying data and assumptions behind each rating agency's methodology. Companies should also prioritize engagement with relevant ESG ratings providers to improve their sustainability reporting and disclosures. The concept of materiality should be dynamic and evolve over time, with companies continuously monitoring changing stakeholder expectations. Direct engagement with investors through sustainability reporting and showcasing ESG efforts through roadshows and conferences are crucial for companies to address investor concerns and improve their ESG practices.

Finally, a reflective analysis is undertaken on green, social, and sustainability bonds which have become increasingly popular in recent years. These bonds offer a range of benefits for companies, including promoting positive public relations, encouraging sustainable operations, aligning funding with sustainability goals, promoting ESG policymaking, attracting a more diverse group of investors, and reducing new issue

concessions. Green bonds also offer a way to finance green projects, which are often in their early stages and not commercially viable yet, and thereby help bridge the gap between financing needs and availability of finance for green projects. They have proven to be a positive step towards promoting sustainable finance and encouraging companies to take a proactive approach towards achieving their environmental and social goals.

In conclusion, this thesis has explored a range of issues related to effective ESG law and regulation, the significance of ESG in investment decision-making, and strategies for businesses to integrate ESG initiatives to support sustainable development while generating value. Through this analysis, it is evident that ESG considerations are crucial for businesses to achieve long-term success, respond to the growing demand from investors and other stakeholders, and contribute to the broader goals of sustainability. As such, the findings presented in this thesis emphasize the importance of incorporating ESG considerations into decision-making processes at all levels and provide a valuable resource for those seeking to navigate the complex landscape of ESG and sustainable investment.

BIBLIOGRAPHY & WEBLIOGRAPHY

Adrien T. (2021), “Heart of steel: how trade unions lobby the European Union over emissions trading”, in Environmental Politics, Vol. 30(7) (pp. 1217-1236)

Agliardi E., Agliardi R. (2019), “Financing environmentally-sustainable projects with green bonds” in Journal of Environment and Development Economics, Vol. 24(6) (pp. 608-623)

Ahmed A. (2010), “Global financial crisis: an Islamic finance perspective” in International Journal of Islamic and Middle Eastern Finance and Management.

AIMA (2020) “AIMA Comments on the European Commission’s Targeted Consultation on the Functioning of the ESG Ratings Market in the European Union and on the Consideration of ESG factors in Credit Ratings”, June

Akgun O.T., Mudge T.J., Townsend B. (2021), “How Company Size Bias in ESG Scores Impacts the Small Cap Investor” in The Journal of Impact and ESG Investing

Alamillos R., de Mariz F. (2022), “How Can European Regulation on ESG Impact Business Globally?”, in Journal of Risk and Financial Management, Vol. 15(7)

Aldowaish A., Kokuryo J., Almazyad O., Goi H.C. (2022), “Environmental, Social, and Governance Integration into the Business Model: Literature Review and Research Agenda” in Sustainability, Vol. 14(5)

Aliakbari E., Globerman S. (2023), “The Impracticality of Standardizing ESG Reporting (ESG: Myths and Realities)”, Fraser Institute, Canada

AMF (2020), “Position Paper: Call for a European Regulation for the provision of ESG data, ratings, and related services”

Antunes D., Santos A., Hurtado A. (2015), “The communication of the LCA: the need for guidelines to avoid greenwashing”, in Espacios, Vol. 36(5)

Armstrong A. (2020), “Ethics and ESG”, in Australasian Accounting, Business and Finance Journal, Vol. 14(3) (pp. 6-17)

Atkinson R. (2008), “Obedience as the Foundation of Fiduciary Duty”, in Journal of Corporation Law, Vol. 34(1) (pp. 43-98)

Aupperle K.E., Carroll A.B., Hatfield J.D. (1985), “An empirical examination of the relationship between corporate social responsibility and profitability”, in Academy of Management Journal, Vol. 28 (pp. 446-463)

Baid V., Jayaraman V. (2022), “Amplifying and promoting the ‘S’ in ESG investing: the case for social responsibility in supply chain financing”, in Journal of Managerial Finance, Vol. 48(8)

Baker M., Egan M.L., Sarkar S.K. (2022), “How Do Investors Value ESG?”, in National Bureau of Economic Research, No. w30708

Banker R.D., Mashruwala R. (2007), “The moderating role of competition in the relationship between nonfinancial measures and future financial performance” in Contemporary Accounting Research, Vol. 24(3) (pp. 763-793)

Barr S., Gilg A., Shaw G. (2011), ‘‘Helping People Make Better Choices: Exploring the behaviour change agenda for environmental sustainability”, in Applied Geography, Vol. 31(2) (pp. 712-720)

Bauer R., Ruof T., Smeets P. (2021), “Get real! Individuals prefer more sustainable investments” in The Review of Financial Studies, Vol. 34(8) (pp. 3976-4043)

Benabou R., Tirole J. (2010), "Individual and corporate social responsibility", in Economica, Vol. 77, Issue 305, January (pp. 1-19)

Bengo I., Boni L., Sancino A. (2022), "EU financial regulations and social impact measurement practices: A comprehensive framework on finance for sustainable development" in Corporate Social Responsibility and Environmental Management, Vol. 29, Issue 4, January (pp. 809-819)

Berg F., Kolbel J.F., Rigobon R. (2019) "Aggregate Confusion: The Divergence of ESG Ratings", in Forthcoming Review of Finance

Bhutta U.S., Farrukh M., Raza A., Iqbal M.K. (2022), "Green bonds for sustainable development: Review of literature on development and impact of green bonds", in Journal of Technological Forecasting and Social Change, Vol. 175, February

BlackRock (2021), "2021 Sustainability Disclosure: Reporting under the Sustainability Accounting Standards Board ("SASB") Standards and Management Criteria"

Borghesi R., Houston J.F., Naranjo A. (2014), "Corporate socially responsible investments: CEO altruism, reputation, and shareholder interests", in Journal of Corporate Finance, Vol. 26, June (pp. 164-181)

Boubaker S., Lamia C., Himick D., Saadi S. (2017), "It's about time! The influence of institutional investment horizon on corporate social responsibility", in Thunderbird International Business Review, No. 59

Boubakri N., Guedhami O., Kwok C.Y., Wang H. (2019), "Is privatization a socially responsible reform?", in Journal of Corporate Finance, Vol. 56, June (pp. 129-151)

Bradley M., Schipani C.A. (1989), "The Relevance of the Duty of Care Standard in Corporate Governance", in Iowa Law Review, Vol. 75(1)

Brown M.B. (2001), "The Civic Shaping of Technology: California's Electric Vehicle Program" in Science, Technology, & Human Values, Vol. 26, No. 1 (pp. 56-81)

Brown W., Heiland E., Smith J. (2006), "Corporate philanthropic practices", in Journal of Corporate Finance, Vol. 12, No. 5 (pp. 855-877)

Brownstein A.R., Lu C.X.W. et al. (2022), "ESG and M&A in 2022: From Risk Mitigation to Value Creation", in Harvard Law School Forum on Corporate Governance, January

Carney M. (2015), "Breaking the Tragedy of the Horizon – climate change and financial stability", in Speech at Lloyd's of London, 29 September

Caroline F. (2013), "Corporate social responsibility and shareholder reaction: The environmental awareness of investors", in Academy of Management Journal, Vol. 56 (pp 758-781)

Carrol A.B. (1979), "A Three-Dimensional Conceptual Model of Social Performance", in The Academy of Management Review, Vol. 4, No. 4, October (pp. 497-505)

Chatzitheodorou K., Skouloudis A., Evangelinos K., Nikolaou I. (2019), "Exploring socially responsible investment perspectives: A literature mapping and an investor classification", in Sustainable Production and Consumption, Vol. 19 (pp. 117-129)

Chiu I.H.Y. (2022), "The EU Sustainable Finance Agenda: Developing Governance for Double Materiality in Sustainability Metrics", in European Business Organization Law Review, Vol. 23 (pp. 87–123)

CITI (2021), "ESG: increasingly an imperative", April report

Clarkson M.B.E. (1995), "A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance", in The Academy of Management Review, Vol. 20, No. 1, January (pp. 92-117)

CRED (2023), “Disasters Year in Review 2022”, in Cred Crunch, No. 70, April

D.E. Shaw (2022), “Keep the Change: Analyzing the Increase in ESG Ratings for U.S. Equities”, April

Dahlsrud A. (2006), “How corporate social responsibility is defined: an analysis of 37 definitions”, in Corporate Social Responsibility and Environmental Management, Vol. 15 (pp. 1-13)

Delmas M., Burbano V. (2011), “The drivers of greenwashing”, in California Management Review, Vol. 54(1)

Deng X., Kang J., Low B.S. (2013), “Corporate social responsibility and stakeholder value maximization: Evidence from merger”, in Journal of Financial Economics

Dienes C. (2015), “Actions and intentions to pay for climate change mitigation: Environmental concern and the role of economic factors”, in Ecological Economics, Vol. 109 (pp. 122-129)

Dimson E., Marsh P., Staunton M. (2020), “Divergent ESG ratings” in The Journal of Portfolio Management

Direction S., (2023), “How investors can drive corporate sustainability efforts: Shareholder engagement as an effective approach” in Journal of Strategic Direction, Vol. 39, Issue 2

DOL (2015), “Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments” in Federal Register, Vol. 80, No. 206

Edenhofer et al. (2014), “Technical Summary”, in Climate Change 2014: Mitigation of Climate Change, contribution of Working Group III to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change, Cambridge University Press, Cambridge, United Kingdom and New York, NY, USA

European Commission (2019), “Guidelines on non-financial reporting: Supplement on reporting climate-related information”, in Official Journal of the European Union; Information From European Union Institutions, Bodies, Offices and Agencies, C209/1

European Commission (2019), “Regulation (EU) 2019/2088 of the European Parliament and of the COUNCIL of 27 November 2019 on Sustainability-Related Disclosures in the Financial Services Sector”, Articles 1,2,4,6,8,9, Brussels

European Commission (2020), “Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the Establishment of a Framework to Facilitate Sustainable Investment, and Amending Regulation (EU) 2019/2088”, Brussels

European Commission (2020), “The European Green Deal Investment Plan and Just Transition Mechanism explained”

European Commission (2021), “Directive of the European Parliament and of the Council Amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as Regards Corporate Sustainability Reporting”, Brussels

European Securities and Markets Authority (2022), “Outcome of ESMA Call for Evidence on Market Characteristics of ESG Rating and Data Providers in the EU”, June

Fama E. (1970), “Efficient Capital Markets: A Review of Theory and Empirical Work”, in Journal of Finance, Vol. 25(2) (pp. 383-417)

Fawzy S., Osman A.I., Doran J., Rooney D.W. (2020), “Strategies for mitigation of climate change: a review”, in Environmental Chemistry Letters, Vol. 18, April (pp. 2069-2094)

Fetting C. (2020), “The European Green Deal”, in ESDN Report, ESDN Office, Vienna, December

Flammer C., Toffel M.W., Viswanathan K. (2019), “Shareholder activism and firms’ voluntary disclosure of climate change risks”, in Strategic Management Journal, Vol. 42

Freedman M., Stagliano A.J. (1991), “Differences in social-cost disclosures: A market test of investor reactions”, in Accounting, Auditing and Accountability Journal, No. 4 (pp. 68-83)

Freitas Netto S.V., Sobral M.F.F., Ribeiro A.R.B. et al. (2020), “Concepts and forms of greenwashing: a systematic review.”, in Environmental Sciences Europe, Vol. 32(19)

Gady F.S. (2014). “EU/U.S. Approaches to Data Privacy and the “Brussels Effect”: A Comparative Analysis”, in Georgetown Journal of International Affairs Vol. 4 (pp. 12–23)

Giese G., Lee L.E., Melas D., Nagy Z., Nishikawa L. (2019), “Foundations of ESG Investing: How ESG Affects Equity Valuation, Risk and Performance”, in Journal of Portfolio Management, Vol. 45(5), July

Gillan S.L., Koch A., Starks L.T. (2021), “Firms and social responsibility: A review of ESG and CSR research in corporate finance”, in Journal of Corporate Finance, Vol. 66, 101889

Global Reporting Initiative (GRI) (2013), “G4 Sustainability Reporting Guidelines: Reporting Principles and Standard Disclosures”, Amsterdam: Global Reporting Initiative

Global Sustainable Investment Alliance (GSIA) (2020), “Global Sustainable Investment Review 2020”, report No. 5, November

González J.M.C., Ruiz F., Paz M.R., Blanca P.G. (2014), “Interactive socially responsible portfolio selection: an application to the Spanish stock market”, in Information Systems and Operational Research, Vol. 52(3) (pp. 126-137)

Grewal J., Hauptmann C., Serafeim G. (2021), “Material sustainability information and stock price informativeness”, in Journal of Business Ethics, Vol. 171, No. 3 (pp. 513-544)

GRI (2013), “Sustainability G4 Reporting Guidelines”, Implementation Manual

Gutsche G., Zwergel B. (2020), “Investment barriers and labeling schemes for socially responsible investments”, in Schmalenbach Business Review 72, February (pp. 1-47)

Gutterman A.S. (2021), “Sustainable finance and impact investing), in Business Expert Press

Hawley J., Johnson K., Waitzer E. (2011), “Reclaiming Fiduciary Duty Balance” in Rotman International Journal of Pension Management, Vol. 4(2)

Heenetigala K., Lokuwaduge D.S.C., Armstrong A., Ediriweera A. (2016), “Investigation of criteria used for assurance practices of sustainability reporting in Australian listed companies”, report presenting the results of research funded by the VU Central Research Grant Scheme in 2015 for Early Career researchers, Melbourne, Victoria University

Hendrikse J. (2022), “The False Promise of ESG” in Harvard Law School Forum on Corporate Governance, March

Hirai A., Brad A. (2021), “Managing ESG Data and Rating Risk”, in Harvard Law School Forum on Corporate Governance

Hong H., Kacperczyk M. (2009), “The price of sin: The effects of social norms on markets”, in Journal of Financial Economics, Vol. 93, Issue 1, July (pp. 15-36)

Hortense B., Stuart E., Boyadzhiev D., Pettit A., Alladi A. (2021), “European Sustainable Funds Landscape: 2020 in Review. A Year of Broken Records Heralding a New Era for Sustainable Investing in Europe”, in Morningstar Manager Research, February

ICMA (2021), “Green Bond Principles: Voluntary Process Guidelines for Issuing Green Bonds”, June

International Institute for Sustainable Development (IISD), Deloitte&Touche, Business Council for Sustainable Development (BCSD) (1992), “Business strategy for sustainable development: Leadership and accountability for the 90s”, Vol. 3, Issue 3

IPCC (2022), “Summary for Policymakers”, in Climate Change 2022: Impacts, Adaptation and Vulnerability, contribution of Working Group II to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change, Cambridge University Press, Cambridge, UK and New York, NY, USA (pp. 3-33)

Janse K.A., Bradford A. (2021) “European Sustainability Mechanism, Europe Greening the World: The “Brussels effect” on Sustainable Finance”

Jansson M., Sandberg J., Biel A., Gärling T.J. (2014), “Should pension funds’ fiduciary duty be extended to include social, ethical and environmental concerns? A study of beneficiaries’ preferences”, in Journal of Sustainable Finance & Investment, Vol. 4(3) (pp. 213-229)

Junkus J., Berry T.D. (2015), “Socially responsible investing: a review of the critical issues”, in International Journal of Managerial Finance, Vol. 41(11) (pp. 1176-1201)

Katz A., McIntosh. L.A. (2021) “SEC Regulation of ESG Disclosures” in Harvard Law School Forum on Corporate Governance

Kay I., Brindisi C., Martin B., Pay Governance LLC (2020), “The Stakeholder Model and ESG”, posted on Harvard Law School Forum on Corporate Governance, September

KPMG (2023), “ESG due diligence in M&A”, in Clarity on Mergers & Acquisitions 2023, January

Kolstad I. (2016), “Three questions about engagement and exclusion in responsible investment”, in Business Ethics: A European Review, Vol. 25, No. 1 (pp. 45-58)

Langbein J.H. (2005), “Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?”, in The Yale Law Journal, Vol. 114 (pp. 929)

Larcker D.F., Pomorski L., Tayan B., Watts E.M. (2022), “ESG ratings: a compass without direction”, in Rock Center for Corporate Governance at Stanford University Working Paper Forthcoming, August

Lavenex S. (2014), “The power of functionalist extension: How EU rules travel”, in Journal of European Public Policy, Vol. 21, (pp. 885–903)

Lee M.T., Raschke R.L. (2020), “Innovative sustainability and stakeholders’ shared understanding: The secret sauce to performance with a purpose”, in Journal of Business Research, Vol. 108 (pp. 20-28)

Liang H., Renneboog L. (2017), “On the foundations of corporate social responsibility”, in Journal of Finance, Vol. 72(2) (pp. 853-910)

Liekefett K.H.E, Gregory H.J., Wood L. (2021) “Shareholder Activism and ESG: What Comes Next, and How to Prepare”, in Harvard Law School Forum of Corporate Governance, May

Lykkesfeldt P., Kjaergaard L.L. (2022), “Institutional Investors Are Embracing ESG Strategies”, in Investor Relations and ESG Reporting in a Regulatory Perspective, August (pp. 255–259)

Marquis C., Toffel M., Zhou Y. (2016), “Scrutiny, norms, and selective disclosure: a global study of greenwashing”, in Organization Science, Vol. 27(2) (pp. 483–504)

Matos P. (2020), "ESG and responsible institutional investing around the world: A critical review"

McCarthy S., Oliver B., Song S. (2017), “Corporate social responsibility and CEO confidence”, in Journal of Banking & Finance, Vol. 75, February (pp. 280-291)

McKinsey (2019), “Five ways that ESG creates value”, Quarterly report, November

McWilliams A., Siegel D. (2000), “Corporate social responsibility and financial performance: Correlation or misspecification?” in Strategic Management Journal, Vol. 21 (pp. 603-609)

Mlik M. (2015), “Value-Enhancing Capabilities of CSR: A Brief Review of Contemporary Literature”, in Journal of Business & Ethics, No. 127 (pp. 419–438)

Morseletto P., (2020), “Targets for a circular economy”, in Resources, Conservation and Recycling, Vol. 153

National Conference of Commissioners on Uniform State Laws (1994), “Uniform Prudent Investor Act (UPIA)”

Nilsson A., Sonanz GmbH, Robinson D., Duke University (2017), “What Is the Business of Business?” in Innovation Policy and the Economy, Vol. 18, edited by Josh Lerner and Scott Stern Duke I&E Research, No. 2017-12

Nir S. (2020), “One duty to all: the fiduciary duty of impartiality and stockholders' conflict of interest”, in Hastings Bus. LJ, Vol. 16

Parguel B., Benoit-Moreau F., Russell C. (2015), “Can evoking nature in advertising mislead consumers? The power of executional greenwashing”, in International Journal of Advertising, Vol. 34(1) (pp. 107-134)

Phillips R., Schrempf-Stirling J., Stutz C. (2019), “The Past, History, and Corporate Social Responsibility”, in Journal of Business Ethics, No. 166 (pp. 203-213)

PRI (2018), “The European Commission Action Plan, financing sustainable growth: assessment of the reform; areas for PRI signatories”, Version 2, July

PRI (2021), “Fiduciary Duty in 21st Century”, Final Report

Raghunandan A., Rajgopal S. (2022), “Do ESG Funds Make Stakeholder-Friendly Investments?”, in Review of Accounting Studies

Ryszawska B. (2016), “Sustainability transition needs sustainable finance”, in Copernican Journal of Finance & Accounting, Vol. 5(1), (pp. 185-194)

Rogge M. (2022), “Humanity constrains loyalty: Fiduciary duty, human rights, and the corporate decision maker”, in Fordham Journal of Corporate and Financial Law, Vol. 26, No. 1 (pp. 147-182)

Rose A.M. (2021), “A Response to Calls for SEC-mandated ESG Disclosure”, in Washington University Law Review 98

Sacconi L. (2012), “Corporate Social Responsibility and Corporate Governance”, in EconomEtica, No. 38, June

Schoenmaker D. (2017), “From Risk to Opportunity: A Framework for Sustainable Finance”, Rotterdam School Of Management, Erasmus University, September

Singh J., Sanchez M.S., Bosque I.R. (2008), “Understanding corporate social responsibility and product perceptions in consumer markets: A cross-cultural evaluation”, in Journal of Business Ethics, Vol. 80 (pp. 597-611)

Solomon R.C., Hanson K.R. (1985), “It's good business”, NewYork: Atheneum

Starks L.T. (2009), “EFA keynote speech: corporate governance and corporate social responsibility: what do investors care about? What should investors care about?”, in Review of Finance, Vol. 44(4) (pp. 461-468)

Susan N.G. (2019), "Best Interests in the Long Term: Fiduciary Duties and ESG Integration", in University of Colorado Law Review 90, No. 3 (pp. 731-802)

Sustainability Accounting Standard Board (SASB) (2018), “Standards overview”, in SASB Standards Application Guidance

TerraChoice (2010), “The sins of greenwashing: home and family edition”, a report on environmental claims made in the North American consumer market

Torricelli C., Bertelli B. (2022), “ESG screening strategies and portfolio performance: how do they fare in periods of financial distress?” in CEFIN Working Papers, Università di Modena e Reggio Emilia, Dipartimento di Economia "Marco Biagi"

Trustco Bank (2022), “Socially Responsible Investing”, Albany, NY, January

Tsalis T.A., Malamateniou K.E., Koulouriotis D., Nikolaou I.E. (2020), “New challenges for corporate sustainability reporting: United Nations' 2030 Agenda for sustainable development and the sustainable development goals”, in Corporate Social Responsibility and Environmental Management, Vol. 27, Issue No. 4, August (pp 1617-1629)

U.S. Government Accountability Office (GAO) (2020), “Public companies: Disclosure of environmental, social and governance factors and options to enhance them”, GAO-20-530

UNCCS (2019), “Climate action and support trends”, based on national reports submitted to the UNFCCC secretariat under the current reporting framework

United Nations (UN) (2015) “Transforming our world: The 2030 Agenda for sustainable development”

Vagts D.F., Koh H., Dodge W.S., Buxbaum H. (2014), “Transnational Business Problems”, in University Casebook Series, 5th edition

Valentin A., Spangenberg J.H. (2000), “A guide to community sustainability indicators” in Environmental Impact Assessment Review, Vol. 20, Issue 3 (pp. 381-392)

Walter I. (2020), "Sense and nonsense in ESG ratings", in Journal of Law, Finance and Accounting

Wang J., Chen X., Li X., Yu J., Zhong R. (2020), “The market reaction to green bond issuance: evidence from China”, in The Pacific-Basin Finance Journal, Vol. 60, Article 101294

WBCSD (2000), “Eco-efficiency: creating more value with less impact”, in World Business Council for Sustainable Development, Conches-Geneva (pp. 32)

WCED (1987), “Report of the World commission on environment and development” by the Secretary-General, in Our common future, Brundtland report (pp. 1-91)

WEF (2020), “The Global Risks Report 2020”, in Insight Report, 15th Edition

Wilkinson A., Hill M., Gollan P. (2001), “The sustainability debate”, in International Journal of Operations & Production Management, Vol. 21(12) (pp. 1492-1502)

Yildirim S. (2023), “Greenwashing: a rapid escape from sustainability or a slow transition?”, in LBS Journal of Management & Research

Yue X-L., Gao Q-X. (2018), “Contributions of natural systems and human activity to greenhouse gas emissions” in Advances in Climate Change Research, Vol. 9, Issue No. 4, December (pp 243-252)

Zhou G., Liu L., Luo S. (2022), “Sustainable development, ESG performance and company market value: Mediating effect of financial performance”, in Business Strategy and the Environment, Vol. 31, Issue7, November (pp. 3371-3387)

Zhou X., Cui Y., (2019), “Green Bonds, Corporate Performance, and Corporate Social Responsibility” in Sustainability, Vol. 11(23)

https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_24 (accessed on 15 April 2023)

https://www.unpri.org/about-us/about-the-pri (accessed on 15 April 2023)

https://www.oxfordbibliographies.com (accessed on 20 April 2023)

https://hbr.org/2014/08/ges-failure-of-ecomagination (accessed on 24 April 2023)

https://casetext.com/case/lg-electronics-usa-v-department-of-energy (accessed on 24 April 2023)

https://earth911.com/business-policy/greenwashing-good/ (accessed on 26 April 2023)

https://www.raconteur.net/sustainability/greenwashing-really-bad/ (Accessed on 26 April 2023)

https://grist.org/article/greenwashing-is-better-for-business-than-real-sustainability-efforts/ (Accessed on 29 April 2023)

https://www.reuters.com/business/sustainable-business/companies-should-take-more-action-climate-norways-sovereign-fund-says-2021-12-01/ (accessed on 29 April 2023)

https://www.ngfs.net/en/communique-de-presse/us-federal-reserve-joins-ngfs-and-two-new-publications-released (accessed on 6 May 2023)

https://www.morningstar.com/articles/1035554/sustainable-fund-flows-reach-new-heights-in-2021s-first-quarter (accessed on 6 May 2023).

https://www.skadden.com/insights/publications/2021/02/esg-key-trends-in-2020-and-expectations-2021 (accessed on 6 May 2023)

https://aplanet.org/resources/green-bonds/ (accessed on 12 May 2023)

https://www.enel.com/company/stories/articles/2023/02/new-framework-sustainable-finance-group (accessed on 12 May 2023)

https://finance.ec.europa.eu/sustainable-finance/tools-and-standards/european-green-bond-standard_en (accessed on 12 May 2023)

https://corporatefinanceinstitute.com/resources/wealth-management/fiduciary-duty/ (accessed on 11 May 2023)

https://www.msci.com/our-solutions/indexes/esg-indexes (accessed on 11 May 2023)

https://www.bloomberg.com/news/articles/2022-03-08/esg-funds-had-8-3-billion-in-russia-assets-right-before-the-war#xj4y7vzkg (accessed on 05 May 2023)

https://capitalmonitor.ai/strategy/responsilbe/how-exposed-are-esg-funds-to-weapons/ (accessed on 8 May 2023)

https://www.bcg.com/publications/2022/green-deals-on-the-rise-according-to-the-latest-mergers-and-acquisitions-report (accessed on 15 May 2023)

https://www.unepfi.org/banking/more-about-the-principles/progress/prb-collective-progress-report-2021/ (accessed on 20 May 2023)

https://www.weforum.org/agenda/2022/09/norways-massive-sovereign-wealth-fund-sets-net-zero-goal/ (accessed on 20 May 2023)

SUMMARY

In the last two decades, policymakers, companies, and public opinion have increasingly recognized climate change and environmental issues as central concerns. To mitigate the adverse effects of climate change, companies are called upon to adopt proactive measures to promote sustainability. It is imperative for businesses to do so primarily to comply with the multitude of recent regulations developed to address these issues, but also to seize the opportunity to attract value.

The concept of sustainable development has been explored extensively in the literature, starting with the Brundtland report in 1987, which introduced the definition of sustainable development as development that meets the needs of the present without compromising future generations. Many international institutions proposed similar definitions for the business community, leading to the introduction of strategies such as "clean production" and "eco-efficiency" in strategic management. The United Nations World Summit on Sustainable Development in 2002 emphasized the triple bottom line concept, which suggests that companies should achieve improved financial performance, environmental protection objectives, and equity for societies simultaneously.

In order to provide an overview of the current landscape, it is crucial to consider the implementation and impact of key international agreements and initiatives. In 2015, the Paris Agreement was signed, representing the first global pact to combat climate change. Alongside this, the United Nations' 2030 Agenda established 17 Sustainable Development Goals, providing a framework for companies to prioritize sustainable strategies. In Europe, in March 2018, the European Commission published an action plan on sustainable finance targeted at increasing the financing of long-term growth, calling on companies to align their business strategies with sustainability objectives and to disclose information on their sustainability performance; the plan includes the establishment of an EU classification system for sustainability activities, creating standards and labels for green financial products, fostering investment in sustainable

projects, incorporating sustainability in investment advice, developing sustainability benchmarks, and enhancing the effectiveness of implementing the principles. Additionally, in 2019, the European Green Deal was introduced by the European Commission, which consists in a set of policy initiatives on sustainable development that aims to make the EU a fair and prosperous society with a competitive economy, while protecting citizens from environmental harms and impacts; its primary objectives are to achieve a carbon-neutral European Union by 2050 and decouple economic growth from resource consumption.

In this context, Corporate Social Responsibility (CSR) has become an increasingly prominent topic in the business literature because of sharp increases in CSR investments, the publication of CSR reports, and in-depth research evaluations. The concept of CSR has evolved over time, with varying interpretations and definitions. Milton Friedman believed that the only social responsibility of business was to maximize profits, while others believe that businesses should also serve other stakeholders. The four-part framework introduced by Archie B. Carroll in 1979 categorizes CSR into economic, legal, ethical, and discretionary expectations. Other definitions of CSR emphasize the obligation of corporations to surpass legal requirements and contribute to the betterment of society and the environment. This involves the management of business processes in a manner that generates a positive impact on society, which should be integrated into the core business strategy rather than treated as an add-on feature such as philanthropy. Interdisciplinary efforts have resulted in integrating the past, history, and CSR thought.

It is of great interest to explore whether CSR is correlated to the corporate financial performance: while the literature on CSR has grown extensively, measuring CSR remains fragmented due to differing viewpoints and methodologies. The Corporate Social Performance Model (CSP) is one approach for assessing CSR, which encompasses the principles, practices, and outcomes of a business's relationships with stakeholders and the environmental impacts of its activities. However, there is no definitive quantitative method for calculating CSR. Various CSR indices exist, such as

the MSCI Kinder social index, which evaluates CSR based on exclusionary screens and attributes related to social responsibility.

Some argue that CSR incurs additional costs that may put businesses at a disadvantage, suggesting a negative or unclear association between CSR and financial performance. However, extensive literature provides compelling evidence that CSR initiatives can significantly increase a firm's overall value. The value of a company encompasses managerial choices that have long-term effects on the firm's operating performance, including factors such as sales revenue, profits, cash flows, and growth potential. A company's value is positively impacted by improved performance, and it can be increased by providing distinctive products, cultivating a devoted customer base, leveraging competitive advantages, or by acquiring other firms to gain synergistic advantages. The value of a company also depends on its idiosyncratic risks: by lowering risks, businesses can increase their value and reduce the cost of capital. Protecting the interests of stakeholders brings numerous advantages to companies: high-quality CSR initiatives can directly enhance a company's value in the short and long term through capital market benefits, such as increased market returns, reduced cost of capital, improved risk management, and decreased information asymmetry. Additionally, CSR can provide advantages in the product market by expanding market share, differentiating from competitors, and building a strong brand reputation. In the employment market, CSR activities can improve employee attitudes, job satisfaction, and motivation, resulting in better operating performance and higher profitability. Furthermore, CSR can bring benefits in the context of mergers and acquisitions, regulatory compliance, and favourable media and legislative coverage.

Overall, managers are driven to pursue CSR activities because of their beneficial impact on the company, as revealed by the rise in CSR investments.

Corporate Social Responsibility (CSR) and Environmental, Social and Governance (ESG) are both concerned with a company's impact on society and the environment, but while CSR is a self-regulating business model used by specific companies, ESG is a set of criteria that investors use to evaluate companies for potential investment. ESG

includes governance explicitly while CSR indirectly includes governance issues related to environmental and social considerations. Corporate finance researchers have hypothesized and documented various connections between ESG/CSR activities and aspects of a firm. Factors such as country characteristics (particularly legal origin), economic development, law, culture, CEO, board characteristics, and ownership structure (including privatization and political environment), influence a company's ESG/CSR activities. These activities can affect a wide range of risk types including systematic risk, regulatory risk, supply chain risk, litigation risk, reputational risk, and physical risk. Indeed, companies with strong ESG/CSR profiles may exhibit greater resilience during crises and enjoy a wider investor base, lower risks, and a lower cost of capital.

Sustainable and Responsible Investments (SRIs) involve investing in activities with positive social and environmental impacts. They attract various types of investors with different motivations, such as environmental, social, or sustainable development concerns. Measuring and managing performance in terms of social benefit and investment returns has led to impact investing, considered an emerging alternative asset class, which aims to generate financial advantages while promoting social good.

Sustainable strategies are considered nowadays as a competitive advantage, while the lack of such strategies is seen as a risk. Sustainability considerations are increasingly influencing investment decisions and shareholder activism, driving businesses to prioritize socially responsible practices: activist shareholders have a new range of powerful themes and standards that they can leverage in their campaigns to influence the management and direction of companies, with individual and institutional shareholders pressuring businesses to adopt these kinds of practices.

The conventional approach to finance focuses solely on financial gain and neglects the interconnectedness of the financial sector with the environment and society. In contrast, sustainable finance takes into account the collective financial, social, and environmental returns. It is crucial for finance to contribute to sustainable development: by directing investments towards sustainable companies and projects, it

can play a vital role in accelerating the transition to a circular economy with low carbon emissions and it enables strategic decision-making that balances sustainable goals and allows investors to influence companies towards more sustainable practices. Additionally, finance can help address uncertainties related to environmental issues by pricing risks for valuation purposes.

To achieve the necessary investment scale for reaching climate and energy targets, private capital should be directed towards sustainable investments. However, obstacles in this field include short-termism, resistance to change from incumbent companies, and aversion to change. Short-termism is a significant barrier as the costs of sustainability actions are immediate, while the benefits are often seen in the distant future: the current financial system's focus on short-term goals, quarterly reporting, and short-term performance measurements which reinforce this short-termism. Overcoming these challenges requires incorporating social and environmental considerations into decision-making and shifting the focus to long-term perspectives.

Behavioural change is essential for sustainable development, but there is often reluctance to change, particularly among incumbent companies that lobby to protect their interests. Investor engagement and shareholder involvement can counteract this lobbying, urging companies to cease such activities. In extreme cases, investors may choose to exclude companies that resist sustainability efforts.

The rise of green markets has led to an increase in greenwashing, which is defined as a company's poor environmental performance combined with positive communication about environmental performance. While stakeholders are putting more pressure on companies to disclose their environmental performance, greenwashing remains prevalent. Greenwashing can take the form of deceptive environmental claims or the use of nature-inspired elements without any explicit environmental claims. Some academics argue that greenwashing can serve as a starting point for promoting sustainability, but policymakers should differentiate between small steps for sustainability and outright fraudulent claims, taking a comprehensive approach to detect greenwashing and implement measures globally to hold firms accountable.

Gradual transition towards sustainability should be encouraged, and rapid disengagement from sustainable practices should be strongly discouraged.
The field of ESG development has gained widespread acceptance among major institutional investors and regulators; companies can no longer ignore its importance as ESG has become a well-established field. BlackRock, the largest asset manager globally, has integrated ESG into approximately 30% of its assets under management. BlackRock's CEO, Larry Fink, has published annual letters to CEOs since 2012, focusing on various themes related to long-term value creation. Fink's letters have played a crucial role in leading institutional investors towards embracing ESG. Moreover, Norway's sovereign wealth fund, the world's largest shareholder, has also transitioned to an active ownership model focused on responsible investing and has implemented an ESG framework. The fund screens and monitors companies based on its policy standards, exercises ownership through voting at company Annual General Meetings, and maintains transparency through a live-updated list of companies it owns and its voting record. The actions of BlackRock and Norway's sovereign wealth fund highlight the stages in the evolution of institutional investors' perspectives on ESG. Companies that have a well-articulated long-term strategy and a clear plan to address the transition to a net-zero economy will differentiate themselves with stakeholders, while those that do not may see negative impacts on their businesses and valuations.
The COVID-19 pandemic has brought a strong attention to the social factors, highlighting issues of inequality that have historically been overlooked. Companies are being judged on their social responsibility during this crisis, and it is recommended that they safeguard work contracts and wages, offer health access, paid sick leave, and engage with stakeholders and communities. By focusing on the "S" aspect of ESG and implementing strong measurement and metrics, organizations can better understand their impact and make sustainable changes. However, social reporting requirements must strike a balance between enhancing transparency and being flexible enough to respond to changing needs.

ESG investing has led to a shift in investment strategies, with a growing trend of combining multiple sustainable approaches. Exclusionary screenings have been replaced by more positive screening approaches that identify companies leading in ESG performance. ESG integration is nowadays the largest sustainable investment strategy adopted worldwide, followed by negative/exclusionary screening and corporate engagement/shareholder action. Investors are progressively adopting more advanced methodologies that incorporate ESG factors into their comprehensive investment strategies. This enables investors to not only steer clear of companies with negative societal or environmental impacts, but also to identify those at the forefront of sustainable practices and social responsibility. Overall, the increasing accuracy of ESG investment strategies is a positive development for both investors and society.

Companies that have strong ESG profiles shows better business performance, more stable market values, and a more resilient stock price in the face of extreme risks. Investors are increasingly seeking to align their investments with their values, and companies with strong ESG profiles have an advantage in attracting capital.

ESG criteria also influence a growing number of M&A transactions, with investors willing to pay premiums for targets with strong sustainability stories. Climate change and greenhouse gas emissions are the two leading factors that many shareholders and investors scrutinize, creating pressure on companies to address these issues effectively. ESG and M&A are inextricably linked, and companies that fail to consider ESG factors in their M&A decision-making may face significant challenges and risks: companies that prioritize ESG concerns will be better placed to capture value and succeed in today's business environment, appealing as attractive entities able to diversify risks and look for new opportunities.

The EU has played a significant role in consolidating and implementing mandatory regulations, such as the Non-Financial Reporting Directive (NFRD), Sustainable Financial Disclosure Regulations (SFDR), and EU Taxonomy. These regulations aim to promote transparency, mitigate greenwashing, and establish consistent standards for environmentally sustainable economic activities. They require companies to disclose

their impact on ESG factors, classify their products into categories with additional disclosure requirements, and report on sustainability risks and adverse impacts. The EU's regulatory strategy focuses on redirecting investments toward sustainable technologies and long-term business models. These regulations contribute to the development of a new sustainability landscape and emphasize the importance of ESG considerations in corporate and investment practices. Europe is definitely leading the way in ESG implementation.

The "Brussels Effect" refers to the EU's ability to set regulatory standards that prompt other regions to adopt similar regulations in order to participate in the EU market. Countries around the world, including the UK, New Zealand, Japan, Switzerland, South Africa, Brazil, Mexico, and Canada, are aligning with EU standards, and making climate-related financial disclosures mandatory. The US has also shifted its stance on ESG issues, with the introduction of the ESG Disclosure Simplification Act and proposed SEC rules on ESG disclosures. The "Brussels Effect" demonstrates the influence of EU regulations in shaping global ESG standards, but challenges remain in achieving regulatory cooperation and harmonization. Efforts are needed to standardize regulations, prevent greenwashing, and encourage transparency and collaboration among key players.

The integration of ESG factors in fiduciary duties poses challenges for fund managers seeking to reconcile their responsibilities with promoting ESG goals while generating returns for investors. While the commitment to ESG is commendable, managers must be cautious due to potential conflicts of interest and information asymmetry between managers and beneficiaries. Fiduciary duty refers to the obligation of fiduciaries to manage finances in the best interests of their clients or beneficiaries. To understand how ESG can be integrated into fiduciary duties, it is possible to analyse the different aspects of fiduciary duty and their implications for ESG integration.

The Duty of Obedience requires fiduciaries to adhere to instructions pertaining to the trust, plan, or charity they oversee: these instructions may encompass specific guidelines related to investment decision-making. In some cases, private trust

instructions may even include provisions regarding environmental and social issues, thereby necessitating compliance with these factors.

The Duty of Loyalty mandates that fiduciaries prioritize the interests of the company and its shareholders above their personal interests. This duty has raised concerns regarding the compatibility of ESG investing with fiduciary obligations, especially when it involves potentially sacrificing financial returns for specific social causes. However, recent reports indicate that integrating ESG factors into investment strategies does not necessarily come at a cost and indeed may enhance long-term returns. Fiduciaries can also take into account the sustainability preferences of beneficiaries and clients, even if these preferences are not financially material, further aligning their actions with the Duty of Loyalty.

The Duty of Care or Prudence requires fiduciaries to manage assets with reasonable care, skill, and caution. Recognizing the potential benefits of ESG integration, the Department of Labor acknowledges that considering ESG factors can lead to superior financial outcomes. As fiduciaries strive to fulfil their duty of care, ignoring ESG factors may expose portfolios to uncompensated risks arising from systemic issues such as climate change and political unrest. Consequently, prudent investors are encouraged to incorporate ESG considerations into their decision-making processes.

Fiduciaries are also bound by the Duty of Impartiality, obligating them to act impartially toward multiple generations of beneficiaries. While this duty does not require equal treatment for all beneficiaries, fiduciaries must consider the distinct needs of both current and future beneficiaries. This duty underscores the significance of evaluating long-term systemic risks and recognizing the interconnections between past, present, and future events; neglecting crucial long-term information may contravene the fiduciary's obligation to act as a prudent investor.

By understanding the implications of these duties and considering ESG factors within their decision-making processes, fiduciaries can fulfil their obligations while harnessing the potential benefits of sustainable investing.

The fiduciary duty of corporate decision makers is constrained by the value of human rights, which have equal normative status as corporate loyalty. Corporate directors must follow the fiduciary mandates of their jurisdiction, but the global parent company can establish firm-wide policies that subsidiaries must follow, including policies to respect human rights.

The ESG landscape is complex and includes various ratings firms that evaluate companies based on ESG criteria. However, the shortage of reliable data and the varying methodologies employed by these firms hinder the broader acceptance of ESG strategies. ESG ratings agencies, such as MSCI, ISS ESG, and Sustainalytics, use different scales and approaches to evaluate ESG quality. The methodologies and reliability of these ratings are often questioned, and patterns such as larger companies receiving higher ratings and European companies scoring higher than their U.S. counterparts have been observed. Providers are expanding coverage to include smaller companies and emerging markets, but this could widen inequality.

ESG ratings tend to increase over time, but studies suggest that they have low associations with environmental and social outcomes. Passive investment products often rely on a single ESG rating provider, and their methodologies may not accurately reflect investment performance. The reliability of ESG ratings as predictors of investment risk or return and improvements in stakeholder outcomes is uncertain. There is a need to address the challenges in measuring ESG: better reporting, transparency, and clear voting practices are also necessary in the ESG ratings industry. While many investors and fund managers direct their investments towards companies with high ESG ratings to make a positive impact, there are concerns about whether these ratings truly reflect a company's commitment to environmental concerns, selectivity in engaging with societies, and focus on countries with good corporate governance. Recent accusations suggest that ESG rating agencies have failed to adequately consider the risks associated with firms that remained heavily exposed to Russia despite the ongoing war. A Harvard study highlights an ESG rating gap in

favour of these firms compared to comparable firms that severed relations with Russia, particularly in the "S" pillar and the Human Rights component.

The study focuses on European firms with a substantial presence in Russia and reveals that those with significant operations in Russia tend to have higher average ESG scores compared to similar-sized non-financial European companies. The research also shows that there is no statistical association between ESG scores and a timely response to the Russian invasion, indicating that higher ESG scores do not necessarily translate into more socially responsible behaviour during a crisis.

ESG funds have also faced controversy. It was expected that these funds would provide a higher level of protection during the current crisis. However, sustainable investment funds that remained exposed to Russian government securities and Russian oil and gas companies experienced losses. This raised doubts about the effectiveness of ESG funds in selecting securities in portfolios.

The debate extends to whether the armaments sector should be excluded from sustainable finance. The conflict in Ukraine has reignited discussions about whether weapons manufacturers' stocks can be considered ESG investments. Some argue for re-evaluating the ESG credentials of weapons makers, while others assert the necessity of defence for maintaining peace and stability. A shareholder advocacy group's database shows that over half of sustainable funds have exposure to military weapons, indicating that many ESG funds hold stocks of companies connected to the weapons industry.

Regulatory interventions and shared standards among major markets are necessary to address these issues. The controversy surrounding ESG funds is modest in terms of the number of funds involved but notable in terms of reported losses. The need for effective selection criteria in passive ESG funds is highlighted. It is also important to distinguish between sustainable finance and ethical finance, as false expectations can arise when the two are confused. Improvements are needed to clarify the path toward sustainability, addressing weaknesses in ESG ratings, greenwashing, and the distinction between different types of sustainable investments.

Research has highlighted inconsistencies among ESG ratings providers, attributed to scope divergence, measurement divergence, and weighting divergence.

Scope divergence occurs when companies are assessed on different ESG factors, leading to different scores. Measurement divergence is the most significant contributor to score differences, as providers use different indicators to assess the same ESG issues. Weighting divergence refers to differences in the importance assigned to ESG factors, resulting in varied scores. Understanding the methodologies of different ratings providers is crucial for companies, as ESG ratings are used to select constituents of ESG indices, influencing investment decisions.

Currently, ESG data and ratings providers are not regulated like credit rating agencies, but proposals for European regulatory frameworks have been made to enhance transparency and manage conflicts of interest.

To engage stakeholders, companies should use sustainability reporting and create a dedicated section on their website. Direct engagement with investors through roadshows and conferences is crucial to explain sustainability strategies and address concerns. ESG ratings and data providers are increasingly important for investors, and companies should prioritize engagement to improve their practices and disclosures.

Overall, transparency, understanding methodologies, and proactive engagement are key for companies to navigate the ESG ratings landscape effectively.

The world recognizes the need for efficient capital utilization to improve living standards and foster prosperity. To reshape the global economy in alignment with Sustainable Development Goals (SDGs), the financial industry must understand their implications. This requires the introduction of new financial instruments to provide capital for environmentally friendly projects.

One such instrument is green bonds, which can be issued by various entities like governments, corporations, and non-profit organizations. These bonds are used to finance environmentally sustainable and socially responsible projects, attracting investors interested in supporting such initiatives. They can fund a wide range of

projects, including renewable energy, biodiversity conservation, pollution prevention, and sustainable development.

Green bonds function similarly to conventional bonds, with entities issuing them to investors to finance sustainable projects. However, green bonds differ by being linked to specific projects with positive environmental and social impacts. They are subject to greater transparency and accountability, often certified and evaluated by independent bodies to ensure their sustainability. Investing in green bonds allows individuals to support these projects while receiving financial returns.

COVID-19 related bonds have seen a surge in issuances to fund pandemic response and relief packages. UN SDG and KPI-Linked Bonds are emerging as an important trend, incentivizing issuers to meet sustainability targets while attracting socially responsible investors.

The European Commission's release of the EU Green Bond Standard provides clearer definitions of sustainable economic activities for issuers and investors. Companies with poor ESG practices face challenges in pricing, attracting and retaining investors, and maintaining performance.

Issuing green bonds offers several benefits for companies, including raising external and internal awareness, aligning funding with sustainability strategies, promoting ESG policy making, diversifying investors, and potentially reducing new issue concessions. Green bonds contribute to bridging the financing gap for green projects and encouraging environmentally friendly practices.

There is ongoing debate about whether funds raised through green bonds are genuinely used for climate-friendly projects or if they contribute to "greenwashing"; secondary risks include additional costs for opinions, assurance, and reporting, as well as coordination complexities.

Research suggests that certain characteristics of green bond issuers, such as positive social reputation and participation of long-term investors, are associated with a premium known as the "Greenium."

Macroeconomic indicators, regulatory support, and institutional sponsorship are critical for the development of the green bond market. The COVID-19 pandemic has posed challenges for funding environmentally friendly projects, requiring further research on the future of green investments in the post-pandemic era. A comprehensive strategy is necessary to address environmental challenges and develop instruments for financing such projects.

To conclude, this thesis has examined various topics concerning effective ESG law and regulation, the significance of ESG in investment decision-making, and methods for companies to incorporate ESG initiatives to promote sustainable development and generate value. The analysis shows that ESG factors are vital for businesses to achieve lasting prosperity, meet the increasing expectations of investors and other stakeholders, and contribute to the wider goals of sustainability. The results of this thesis highlight the necessity of integrating ESG considerations into decision-making procedures at every level and may serve as a useful guide for those looking to navigate the intricate ESG and sustainable investment landscape.