Valoris
Stewardship Catalysts

Investors are growing increasingly uncomfortable with the ESG label

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Ron Lieber recently interviewed two high-profile investors in the ESG space, Amy Domini of Domini Impact Investors and Rachel Robasciotti of Adasini Social Capital, for his Your Money column in the New York Times. His opening query to each was "What's the most accurate definition of ESG today, and how has it changed?" Perhaps surprisingly, perhaps not, both Ms. Domini and Ms. Robasciotti deliberately ducked the question. Ms. Domini preferred instead to describe her own approach as "ethical investing" and lamented losing vocabulary battles over the course of her long career. Ms. Robasciotti responded by calling her firm's approach "social justice investing", and like Ms. Domini avoided directly responding to Mr. Lieber's question of what, exactly, ESG investing really means. Frankly, I don't blame them.

A well-known corporate governance leader once described ESG to me as an unstable molecule. What holds it together? Why should investors talk about bundling assessment of environmental, social and governance? Are these even coherent categories? Is ESG simply a term to organize consideration of non-traditional factors? Do investors and companies look at ESG the same way? What's objective and what's subjective in each category? Can anyone at investors or companies be an expert in all three? And who decides what's important, what's nice to have and what's a distraction?

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Corporate governance professionals have always found the term ESG problematic and fraught. From a corporate governance perspective, environmental and social considerations are objects of governance. Effective corporate governance is the sine qua non of effective long-term management of any enterprise. Senior executives, board members and investors all play a direct role in governance – company oversight, strategic direction, risk management, the control environment and transparency. It is within the framework of corporate governance that these actors – the people with the greatest interest in and power over the direction of the company – ensure that due attention is paid to all internal and external factors material to the operation of the enterprise, whether organized along the lines of environmental and social categories, or otherwise.

The foregoing is not intended in any way to belittle the importance of careful attention to environmental and social factors in the operation of companies or the management of investment portfolios. Just the contrary. The climate crisis in particular has made company managers, board members and investment professionals increasingly aware of how complex such issues are, how well-tailored investors' and companies' approaches need to be, and how much they necessarily rely on outside expertise and advice. Plenty of executives and investors are governance literate; none can be fully ESG competent. The field, if it really exists at all, is simply too broad for a priesthood.

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So let's go back to Mr. Lieber's question, what does it mean to be an ESG investor? If it means that the investor considers certain non-traditional factors pigeonholed under one or more of the three categories, doesn't that cover pretty much any active portfolio? Since at least the revolutions of 1848, investors have understood that how companies treat their workers is something worth looking at. Regulatory risk is a relevant factor in the valuation process for most industries – environmental and social regulation is ubiquitous. And what about passive portfolios with exclusion lists? Don't they qualify? If so, then the term is so inclusive as to cease to be a meaningful differentiator. And saying that being an ESG investor means having a systematic process of evaluating ESG factors merely begs the question – what counts as a systematic process? How does the investor demonstrate how investment decisions are different because of its application?

If investors can't help squirming when asked to define it, maybe it is time to scrap ESG, even as an umbrella term. Instead of using overbroad, misunderstood or vague labels, institutional investors should be speaking to their clients in terms of the specific factors they think are relevant, the information they collect and analyze, the science behind their methodologies and the results

(financial and non-financial) they believe these generate. This would likely accelerate the emergence of categories more useful than a generic "ESG investing" label. Hopefully, these categories will be ones that investors will be comfortable using in front of journalists (and the investors' clients).

There are instances when we at Valoris find ourselves still using the term ESG investing for lack of a better alternative. But we do so in the full knowledge that it is an imprecise term, susceptible to accidental and intentional misuse. Wherever we can, we will endeavor to employ more precise terminology, providing explicit reference to context and purpose, in order to contribute to clearer expression and understanding of what enlightened investors are actually doing or should be doing.

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Meet the founders:

Mike Lubrano, Managing Director

Over the past two decades, Mike has worked with scores of investors to integrate the consideration of ESG factors in their investment process and with company boards of directors to improve corporate governance, sustainability practices and transparency. He holds degrees from Harvard College (AB), Princeton University (MPA) and New York University School of Law (JD). He is co-author of ICGN's Governance, Stewardship and Sustainability, published in June 2021.

Mariangeles Camargo, Managing Director

Mariangeles has worked with financial institutions for almost two decades helping improve environmental and social performance, comply with regulatory requirements and respond to increasing expectations of stakeholders, including capital providers. She has extensive expertise in the development of green financial products. She holds a Master of Science in Finance from Bentley College, in Massachusetts, USA.

Martin Steindl, Managing Director

Martin brings over twenty years of experience leading initiatives and teams in FMO, the Dutch development bank, and IFC that helped streamline environmental, social and governance risk management processes when investing in financial institutions and private equity funds in emerging markets. Martin holds a PhD degree from the University of Vienna and Georgia State University and an MBA degree from the HEC School of Management in Paris.

Davit Karapetyan, Managing Director

Davit has more than 20 years experience designing ESG methodologies, tools and internal policies and procedures for institutional investors to apply in their investment and portfolio operations.

He helped develop International Finance Corporation's (IFC) corporate governance methodology, which is today widely used by many other development finance institutions (DFI) as well as private asset managers and private equity funds that are DFI investees. Davit's work includes crafting tailored ESG policies and procedures for a variety of investors to integrate corporate governance

and governance of sustainability analysis in investment and portfolio operations, sharevoting and nominee directorships. Davit has a Ph.D. in Law and is fluent in English and Russian.

About Valoris Stewardship Catalysts

A unique advisory services firm that helps investors and portfolio companies improve corporate governance, investor stewardship and sustainability performance in their operations. Valoris was founded by experienced practitioners in the fields of corporate governance, stewardship and environmental and social sustainability. Valoris serves institutional investors, impact funds, development finance institutions, financial institutions and their portfolio companies. Headquartered in Washington D.C. (USA) and Vienna (Austria), Valoris operates worldwide. www.valoriscatalysts.com