Environmental, Social and Governance (ESG)

ESG is a framework that helps stakeholders understand how an organization is managing risks and opportunities related to environmental, social, and governance criteria (sometimes called ESG factors). ESG takes the holistic view that sustainability extends beyond just environmental issues. The social criterion examines the impact of an entity's operations on the labor and human rights of its employees including diversity and inclusion, workplace conditions, and pay parity and equity; also its, social responsibility. In EU law a sustainable investment includes "an investment in an economic activity that contributes to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration, and labor relations, or an investment in human capital or economically or socially disadvantaged communities[1].

1. Environmental

Environmental factors refer to an organization's environmental impact(s) and risk management practices. These include direct and indirect greenhouse gas emissions, management's stewardship over natural resources, and the firm's overall resiliency against physical climate risks (like climate change, flooding, and fires).

2. Social

The social pillar refers to an organization's relationships with stakeholders. Examples of factors that a firm may be measured against include human capital management (HCM) metrics (like fair wages and employee engagement) but also an organization's impact on the communities in which it operates. A hallmark of ESG is how social impact expectations have extended outside the walls of the company and to supply chain partners, particularly those in developing economies where environmental and labor standards may be less robust.

3. Governance

Corporate governance refers to how an organization is led and managed. ESG analysts will seek to understand better how leadership's incentives are aligned with stakeholder expectations, how shareholder rights are viewed and honored, and what types of internal controls exist to promote transparency and accountability on the part of leadership.

ESG – Governance

The governance criterion refers to the governance factors of decision-making. In EU law, a sustainable investment must not do significant harm to environmental or social objectives and the investee companies must follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff, and tax compliance.

This definition of sustainable investment is to be found in the SFDR Level 2[2]:

Sustainable Investment means an investment in an economic activity that contributes to an environmental or social objective, provided that the investment does not significantly harm any environmental or social objective and that the investee companies follow good governance practices.

A key objective of the European Commission's action plan on financing sustainable growth is to reorient capital flows towards sustainable investment and ensure market transparency. To achieve this objective, the Commission called for the creation of an EU classification system for sustainable activities - an EU Taxonomy.

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[1] https://corporatefinanceinstitute.com/resources/esg/esg-environmental-social-governance/

[2] https://www.arthurcox.com/knowledge/sfdr-preparing-for-level-2-compliance-1-january-2022-deadline/

ESG Data Products

ESG data refers to environmental, social, and governance information that companies disclose to measure their sustainability and ethical practices. It includes data on carbon emissions, diversity and inclusion, labor practices, board composition, and more. ESG data helps investors and stakeholders assess a company's impact on the environment, society, and its governance structure, enabling them to make informed decisions aligned with their values and sustainability goals.

Examples of ESG data include information on a company's carbon emissions, diversity and inclusion metrics, labor practices, and governance structure. ESG data is used by investors, analysts, and stakeholders to assess a company's sustainability and ethical performance. The broad spectrum of data products that are marketed as providing either a specific E, S, or G focus or a holistic ESG focus on an entity, financial instrument, product, or company's ESG profile or characteristics or exposure to ESG, climatic or environmental risks or impact on society and the environment, whether or not they are explicitly labeled as "ESG data products"[3]. The European Commission has proposed a Regulation to apply to transparency and operations of ESG rating providers.

ESG Ratings

ESG Ratings The broad spectrum of rating products that are marketed as providing an opinion regarding an entity, a financial instrument, a product, or a company's ESG profile or characteristics or exposure to ESG, climatic or environmental risks or impact on society and the environment, that are issued using a defined ranking system of rating categories, whether or not these are explicitly labeled as "ESG ratings". ESG Ratings and data product providers are entities who measure an entity/financial instrument/ product's exposure to long-term ESG risks, providing an ESG score as an evaluation of the company's performance against various ESG metrics.

[3] https://datarade.ai/data-categories/esg-data