

Governance Opportunities and Risks, Amidst ESG Backlash



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As Environmental, Social and Governance (ESG) investing falls under increasing political scrutiny in the United States, it creates both risks and opportunities. At Morgan Stanley's inaugural Sustainable Finance Summit, Gwen Le Berre (Head of Responsible Investing, Parametric, MSIM) participated on a panel with WilmerHale Senior Counsel Phil Gillespie, Blue Sky Advisors Executive Director Greg Henke, and Council of Institutional Investors General Counsel Jeff Mahoney about the domestic political environment. In particular, panelists discussed the challenges presented by the differing demands placed on asset managers in individual states as well as overseas, and how investors can mitigate or overcome these challenges.

It's Critical to Define Our Terms

The discussion around ESG has become oversimplified, uncovering a lack of general understanding on what ESG actually is. In particular, there is confusion between ESG and ESG ratings – the latter is opinion, the former isn't. Because of this oversimplification, it is easy to politicize. As a fiduciary we need to explain to our investors that ESG is a framework to assess real risks they need to consider, and we need to do a better job defining our terminology and what it means.

Attacks on ESG in Stemming From Some States Politicians

We've seen some states increase the emphasis on why "woke" active ownership might violate certain state laws, with increased scrutiny on engagement and shareholder proposals. Politicians have made misguided allegations of breach of fiduciary duty, highlighted disclosure – related issues and further pointed to interest groups like NetZero, allegedly acting in collusion.

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Asset Managers Face Pressures From all Sides

While state attorneys general in some states are attacking ESG investing, in other states firms are dealing with laws requiring them to divest in areas like oil and gas. Nationally, the SEC is working to increase disclosure at the company level. And Europe is giving every indication that firms need to take ESG very seriously in order to compete. The asset management industry is stuck in the middle, and this is likely going to get worse in the period leading up to the next US election.

Criticisms About Shareholder Proposals are Overblown

Historically shareholder proposals have ebbed and flowed, and this current proxy season has seen a lower number of shareholder proposals compared to last year both in terms of number of proposals and votes. Regardless, they are a very small fraction of overall proposals. Moreover, these are nonbinding proposals. Shareholder proposals get a lot of attention because the topic is useful for media and attorneys general, but investors tend to be quite conservative about voting against management unless it is about a lack of disclosure or if it is related to poor performance etc.

Differing Global Standards Continues to be a Challenge

While this isn't strictly an ESG problem – multiple ways of gathering data in different geographic areas isn't comparable – coming to a convergence has been challenging. There are at least three major players long-term – the United States, Europe and ISSB. Europe is using double materiality as a requirement, whereas many in the US can't even agree on what materiality means.

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