An analysis of ESG ratings about their informative value, their validity, and their future significance using the example of the European Union

Jennifer Schäfer
152121425

Dissertation written under the supervision of Professor Nuno Moreira da Cruz

Dissertation submitted in partial fulfilment of requirements for the MSc in Management, at the Universidade Católica Portuguesa, January 4, 2023.

Abstract

Title: An analysis of ESG ratings about their informative value, their validity, and their future significance using the example of the European Union

Author: Jennifer Schäfer

Keywords: Sustainability, Corporate Social Responsibility (CSR), Socially Responsible Investment (SRI), Environment, Social, Governance (ESG), ESG-Ratings, European Union (EU)

Redefining CSR beyond its value to shareholders has created a new field of research. Many investors desire to invest the asset sustainably, meaning to consider ESG aspects. The increasing number of investors interested in SRI has led to the parallel development of a market for specialized sustainability perspective ESG ratings. Many investors are dissatisfied with the current situation and overwhelmed to make an informed choice, given the large variety of ratings. This can be explained by the fact that the definition of appropriate criteria that allow a statement about the sustainability of a company and the techniques used by rating agencies to measure these criteria need to be standardized. Using the EU as an example, this research aims to answer what informative value ESG ratings have, and the given informative value can be ensured through data validation. Eight financial or consulting institutions experts were interviewed as part of a qualitative research project. Findings show that practical assistance for investors requires an analysis based on individual decision-making priorities. Investors must be more purposeful in their approach to make an appropriate choice. Previous legislation, such as the EU taxonomy, set a basic framework for a uniform SRI approach, but only for the EU area. All market participants must adapt their strategies to achieve the Net Zero 2050 target.

Abstrato

Título: Uma análise das classificações ESG sobre o seu valor informativo, a sua validade e a sua importância futura, utilizando o exemplo da União Europeia

Autor: Jennifer Schäfer

Palavras-chave: Sustentabilidade, Responsabilidade Social Empresarial (RSE), Investimentos soielmente responsáveis (ISR), Ambiente, Social, Governação (ESG), ESG-Ratings, União Europeia (UE)

Redefinir a RSE como algo que vai para além do valor para os acionistas criou um novo campo de investi-gação. Muitos investidores desejam investir o activo tendo em conta objetivos sustentáveis, o que significa considerar os aspetos do ESG. O número crescente de investidores interessados no ISR levou ao desenvolvimento paralelo de um mercado com a perspetiva de sustentabilidade especializada em ratings de ESG. Muitos investidores parecem insatisfeitos com a situação atual onde é dificl fazer uma escolha informada, dada a grande variedade de *ratings* existentes. Isto pode ser explicado pelo facto de a definição de critérios apropriados que permitem uma declaração sobre a sustentabilidade de uma empresa e as técnicas utilizadas pelas agências de *ratings* para medir estes critérios, não serem muito padronizadas e, portanto, variarem muito. Utilizando a UE como exemplo, esta investigação visa responder ao valor informativo das classificações ESG e como estas podem validar os vários dados disponíveis. Foram entrevistados oito peritos de instituições financeiras ou de consultoria, como parte de um projeto de investigação qualitativa. Os resultados mostram que a assistência prática aos investidores requer uma análise baseada em prioridades de tomada de decisão individuais. Os investidores precisam de ser mais direcionados na sua abordagem para fazerem escolhas mais apropriadas. A legislação anterior, tal como a taxonomia da UE, estabelece um quadro básico para uma abordagem uniforme do ISR, mas apenas para a área da UE. Todos os participantes no mercado devem adaptar as suas estratégias para alcançar o objectivo Net Zero 2050.

Table of Contents

I. List of Abbreviations VI

II. List of Figures VII

III. List of Tables VIII

1. Introduction 1

1.1 Problem of Research 2

1.2 Research Objective 2

1.3 Approach of Work 3

2. Literature Review 4

2.1 Concepts and Definitions 4

2.1.1 Sustainability 4

2.1.2 Corporate Social Responsibility 4

2.1.3 Socially Responsible Investing 6

2.2. Regulation and State of the Art in Reporting 6

2.3 Environmental, Social, and Governance 9

2.3.1 ESG Scores 10

2.3.2 ESG Rating Agencies 10

2.3.3 ESG Strategies 12

2.3.4 ESG Challenges 13

2.3.5 ESG Opportunities 14

2.4 Potential Literature Gap 15

2.5 Hypotheses Formulation 16

3. Methodological Concept 18

3.1 Research Idea and Research Problem Definition 18

3.2 Research Design 18

3.3 Data Collection Method 19

3.4 Data Sample 20

3.5 Data Analysis Procedure 20

4. Data Analysis 21
4.1 Presentation of the Results 21
4.2 Interpretation of the Results 28
4.3 Recommendation for Action 30
5. Conclusion 32
6. Limitation 33
Appendix IX
Bibliography XXV

I. List of Abbreviations

AuM	Asset under Management
CEO	Chief Executive Officer
COP	Conference of the Parties
CSP	Corporate Social Performance
CSR	Corporate Social Responsibilities
ESG	Environmental Social Governance
ESMA	European Securities and Markets Authority
EU	European Union
GRI	Global Reporting Initiative
IFRS	International Financial Reporting Standards
IP	Interview Partner
IPCC	Intergovernmental Panel on Climate Change
ISSB	International Sustainability Standards Board
KLD	Kinder Lydenberg Domini
NGO	Non-Governmental Organisations
MSCI	Morgan Stanley Corporate Institute
SASB	Sustainability Accounting Standards Board
SDG	Sustainable Development Goal
SRI	Socially Responsible Investing
UNFCCC	United Nations Framework Convention on Climate Change

II. List of Figures

Figure 1: Three-pillar model 4

Figure 2: CSR Pyramid 5

Figure 3: Development of SRI 9

Figure 4: Research approach 18

III. List of Tables

Table 1: Differentiation of ESG Ratings 11

Table 2: Correlations between ESG Ratings 11

1. Introduction

"The social responsibility of business is to increase its profits." (Friedman, 1970). With this often-quoted article by the economist Milton Friedman, published in 1970 in The New York Times Magazine, companies today are not willing to identify themselves. However, many companies - whether due to intrinsic motivation or external pressure - are embracing concepts that aim for corporate responsibility beyond purely motivational profit. Regulatory and incentive measures, therefore, encourage companies to act sustainably. However, companies are forced to address sustainability not only by regulation but also to ensure their competitiveness in the marketplace by avoiding controversy and loss of reputation (Bassen, Jastram, & Meyer, 2005).

In the meantime, the issue of sustainability, as well as the broader corporate social responsibility (CSR) approach, have also become a central part of the capital allocation process. Focusing purely on financial aspects as an investment decision criterion is increasingly losing importance. Market studies show that consumers tend to buy products and services from companies that are associated with contributing to sustainability. Due to the ongoing economic crisis, the increasingly harmful effects of globalization, and the associated regulatory gaps about the environment and social relevance, the demand from various stakeholders for companies to assume economic, social, and ecological responsibility is becoming increasingly louder (Schaltegger, 2011). Information regarding poor working conditions or environmental pollution is spreading rapidly via new communication channels and networks, increasing the pressure on companies (Ransome & Sampford, 2010).

BlackRock, the largest multinational asset manager (Statista, 2020), has become a pioneer in integrating sustainability into corporate strategy. The value of a company is defined by much more than just the annual shareholder value. This has also led to more asset managers adopting this approach. Regarding sustainability efforts, Larry Fink – BlackRock's Chief Executive Officer (CEO) - shows that long-term profit maximization can only be achieved with a sustainable business strategy that benefits customers, employees, and the community (Fink, 2021). This allows given companies to remain competitive and generate long-term, sustainable profits for their shareholders. However, interest in companies publicly reporting on their sustainability efforts is not a new concept. The Environmental, Social, and Governance (ESG) metrics have become the standard tool for sustainability comparison and reporting. To provide the growing number of interested investors - both with a philanthropic interest and from a financial perspective - with the necessary basis for making sustainable investment decisions, a market for specialized sustainability perspective ESG ratings has developed in parallel. These

metrics are based on the reporting company's ESG efforts. Many investors seem overwhelmed and unable to make an informed choice, given the wide variety of ratings and approaches (Windolph, 2013). This can be justified by the definition of applicable guidelines and criteria that allow a statement about a company's sustainability. The techniques used by rating agencies to measure these criteria are not standardized and thus vary widely. Additionally, a lack of transparency in the ESG rating market is criticized by investors and researchers as well as by the rated companies themselves. With the increasing importance of these criteria, there is also a growing trend toward greenwashing (Sadowski, Whitaker, & Buckingham, 2010) (Delmas, Dror, & Nairn-Birch, 2013).

1.1 Problem of Research

As the market for ESG rating agencies grows, so does the critique of their informative value. Often, investors need to be aware of the broad range of corporate activities and access relevant data or the necessary expertise to analyze it and identify value-added findings (Chatterji, Levine, & Toffel, 2009). ESG rating agencies seek to provide quantified and, thus, comparable results as a basis for investment decisions. Challenges lie in the transparency, standardization, and credibility of ESG ratings (Windolph, 2011). These problems might be a reason why the proportion of investments for which ESG criteria were considered has fallen. Despite steady growth, Socially Responsible Investment (SRI) shares less than total invested assets (Bergius, 2014). Experts are increasingly skeptical that current ESG ratings are directly related to more sustainable companies. While the ESG framework has evolved as a standardized way to report on these efforts, there needs to be a verification framework for the validity of the reported data.

1.2 Research Objective

The background to this research is the demand by many investors to invest their assets sustainably, meaning to consider ESG aspects when making investment decisions. Despite the justified criticism, ESG ratings have raised awareness of sustainable investment strategies and increased credibility by formalizing ESG assessment and analysis in product packages, enabling further integration of sustainability concerns (Wong & Petroy, 2020). This thesis aims to identify potential opportunities and constraints of ESG ratings to guide investors, companies, and ESG providers.

Therefore, the primary objective is to clarify whether ESG ratings allow an interpretation of sustainability. All stakeholders - investors, employees, supervisory board, regulators, and activists - are interested in companies' social and environmental performance. These issues are too important to rely on poorly tested metrics that offer limited transparency.

According to the introductory problem statement, the following question, which is going to be answered, can therefore be concluded as:

How can ESG data truly validate its significance?

Therefore, it is first necessary to explore the meaning of sustainability, the criteria for ESG-compliant investments, and their meaningfulness in order to examine this research question. Second, it is essential to understand whether there is a trade-off between making money and investing responsibly. Finally, it will be investigated how sustainability-related responsibilities can be assigned. Using expert interviews, the thought processes and opinions on the validity of ESG ratings are elaborated for the European Union (EU). The analysis of expert interviews will provide information on which measurement and evaluation methods the experts consider applicable. Finally, looking back at the theoretical part of this work, potential strengths and weaknesses of ESG ratings will be identified, and recommendations for improvement will be given.

1.3 Approach of Work

The introduction follows the literature review, a theoretical overview of the topic. Terms such as sustainability, CSR, ESG, and the regulatory framework established to date serve as essential knowledge for considering the significance of ESG indicators. The approaches highlighted are of particular relevance for the subsequent linking of theory and practice. To elaborate on the current state of research, various studies are highlighted to form the theory of the present work and to specify the research question. The method of the present qualitative research and the generation of the required data using guided interviews are explained in the methodological concept. Subsequently, the collected data will be analyzed using Mayring's content analysis. The practical part is concluded by merging the findings from theory and practice. Through this merging, the question is to be pursued to what extent the basic theoretical assumptions correspond with the findings obtained in practice. In the last chapter, the results are summarized, and the research question is answered.

2. Literature Review

2.1 Concepts and Definitions

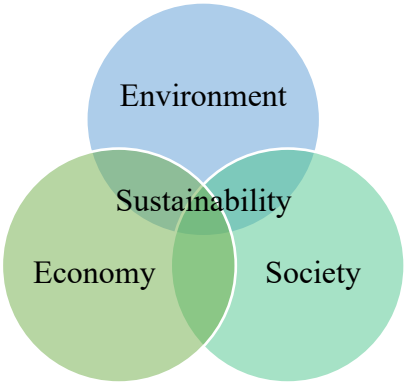
The lack of standardized terminology has led to numerous terms used to describe Sustainable Investing. In order to provide a better overview, the essential terminology will first be defined.

2.1.1 Sustainability

The term sustainability has a vague definition. The most common definition is to meet the needs of the present generation without compromising future generations' abilities (WCED, 1987). During the 1992 UN Conference in Rio de Janeiro, currently considered as the benchmark for integrating environmental and development goals, the following three concepts were established for consideration: environment, economy, and society. These have since become known as the three-pillar model.

Figure 1

Three-pillar model (own representation, based on Purvis, 2019)



The model is based on the idea that sustainable development can only be achieved through the simultaneous and equal fulfilment of ESG goals to ensure the performance of a society (Purvis, 2019).

2.1.2 Corporate Social Responsibility

CSR is the term used to describe a company's moral behavior toward society (Scott, 2007). The goal of CSR is to develop a regenerative system through its activities. Nevertheless, it differs from the concept of sustainability in that CSR focuses on the company and its specific contribution to society, whereas sustainability looks at the entire system.

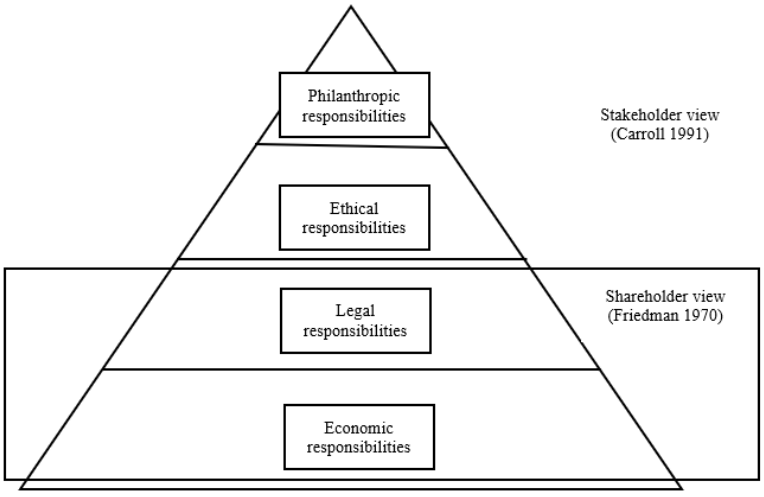
The best-known CSR concept comes from Carroll, who describes CSR as a pyramid consisting of four levels: economic, legal, ethical, and philanthropic responsibility. The model is based on two opposing views of the role of companies in society, namely the shareholder and the stakeholder view of CSR (Carroll, 1991). The shareholder view, also called the shareholder value concept, focuses mainly on the relationship between shareholders and managers. Most

ideas arising from the shareholder value concept have their basis in the agent theory. In the agent theory, managers are agents who run the company solely on behalf of shareholders (Arrow, 1985). According to Ford, this idea is justified because the existence of a company is based primarily on the capital and profits of its shareholders (Dodge v. Ford Motor Co., 1919). Thus, a corporation's sole responsibility is to act in the best interests of its shareholders. Friedman also argues that a company's economic responsibility requires it to use its resources and activities in the best interest of its shareholders to be profitable (Friedman, 1970).

Companies whose interests go beyond maximizing shareholder value may have higher cost structures, for example, because employees are paid higher wages than other market competitors. According to the advocates of the shareholder view, these higher cost structures destroy the shareholder value approach. In the long term, given companies will be displaced by less civic-minded competitors. Representatives of the shareholder view believe that ESG issues are the responsibility of the state or the respective government, as managers are neither trained nor elected to resolve these conflicts. A company's goals, same as those of the individual and the government, are not always separable (Hart & Zingales, 2017). Maximizing shareholder wealth does not always increase benefits to society, but in most cases comes at the expense of society (Serafeim, Kotsantonis, Saltzman, & Ward, 2017). An example of this is the global financial crisis of 2008, where maximizing shareholder value was one of the key trigger factors. The stakeholder approach argues that groups other than shareholders, such as employees, customers, or the public, should be included in the governance process. The core idea of stakeholder theory is that management must balance the interests of shareholders with the competing interests of stakeholders to ensure the long-term viability of an organization (Crane & Matten, 2010).

Figure 2

CSR Pyramid (own representation, based on Carroll, 1991)



In addition to economic and legal, there are ethical and philanthropic responsibilities. Ethical refers to activities that are not legislated but are considered fair and thus desired by society. The boundary between ethical and legal responsibilities is dynamic, as most ethical responsibilities become legal responsibilities over time. Ideally, a country's legal system reflects the moral standards of its society. Philanthropic responsibility means incorporating the well-being of all humanity into corporate decision-making processes (Tuzzolino & Armandi, 1981). Following Maslow's well-known hierarchy of needs, the lower level must be fulfilled before the next higher level can be considered. First, it is the economic responsibility of a company to make profits. Second, a company should focus on obeying the law. Third, it is a company's social responsibility to act ethically, and finally, a company should try to be a good corporate citizen (Carroll, 1991).

With all its facets, sustainability is consequently increasing interest to companies, investors, and other socially and economically acting objects.

2.1.3 Socially Responsible Investing

SRI is often used in common parlance without sufficient differentiation. As a specific term, SRI is associated with various approaches in the scientific literature. SRI can also be found complementarily under the terms ethical investing, green investing, or ESG investing. It seeks to generate social change and financial returns as an investment strategy. SRI can include companies with a positive, sustainable, or social impact. Investors and companies want to know if a particular business strategy is worthy of funding or can generate high enough returns to continue attracting money from private investors (Ransome & Sampford, 2011). If so, the question remains about how investors (and companies themselves) can evaluate a company's sustainability investments and programs.

2.2. Regulation and State of the Art in Reporting

A key driver of the change towards more sustainability is the EU taxonomy. By 2050, the 27 EU member states will become carbon-neutral and aim to eliminate harmful emissions from then on (European Parliament, 2021). However, the origin of these initiatives goes back several decades. In 1992, 154 countries signed the first United Nations Framework Convention on Climate Change (UNFCCC). At its inception, the UNFCCC focused primarily on facilitating intergovernmental negotiations on climate change (United Nations Climate Change, 2022). As the importance of sustainability increased, so did the investment demand from investors for companies that reflected these values. In 1990, the Morgan Stanley Capital International (MSCI) Kinder, Lydenberg & Domini (KLD) 400 Social Index was founded in response to this demand. As the first benchmarking index for SRI, it was able to rank companies against their

industry peers on ESG factors. Since then, it has been accepted as a performance standard and a basis for conducting a scientific debate (Sharfman, 1996).

The next step was taken in 1997 by adopting the Kyoto Protocol, which laid down the framework conditions for the UN climate conventions. The protocol came into force in 2005. Although the members commit themselves to reduce greenhouse gas emissions, there are only requirements and no binding rules (United Nations Climate Change, 2022). In 1997, the Global Reporting Initiative (GRI) – the provider of the world's most widely used standards for sustainability reporting - was founded. Since many stakeholders are involved, reporting according to GRI is considered transparent, standardized, and comparable. The Sustainability Accounting Standards Board (SASB), a non-profit organization founded in 2011, works with the GRI to help companies and investors track and adequately report their sustainability issues. Many companies use the SASB and GRI standards to meet the needs of their audiences.

In October 2016, 195 countries, among them the 27 EU member states, decided to limit global warming to well below 2 degrees Celsius as part of the Paris Agreement and to continue efforts to limit it to 1.5 degrees Celsius (European Commission, 2022). In 2018, the IPCC (Intergovernmental Panel on Climate Change), a United Nations committee, published the special report *Global Warming of 1.5 degrees Celsius*, which states that to achieve the 1.5 degrees Celsius target, greenhouse gas emissions must be reduced to net zero by 2050 or earlier. At the UN Climate Change Conference in Glasgow in October 2021 (COP 26), governments were called upon to accelerate the phase-out of coal, curb deforestation, switch to electric vehicles, and invest in renewable energies (UN Climate Change Conference, 2021). During the conference, the International Financial Reporting Standards (IFRS) Foundation announced the establishment of a new standard-setting board - the International Sustainability Standards Board (ISSB). IFRS is a set of accounting standards that specify the types of transactions and events that must be disclosed in financial statements. Established in November 2021, the ISSB was requested by international investors with global investment portfolios for high-quality, transparent, reliable, and comparable reporting by companies on ESG issues. The goal is to provide sustainability-related disclosure standards to help investors make informed decisions (IFRS, 2022).

On February 2, 2022, the EU Commission decided in the EU Taxonomy to accelerate energy production based on gas and nuclear technologies for a climate-neutral future, in line with the EU's environmental goals (European Commission, 2022). In addition, reference was made once again to the 17 Sustainable Development Goals (SDGs) summarized in 2015 by the United Nations in Agenda 2030 in order to enable a dignified life worldwide and at the same time to

be able to preserve the natural foundations of life in the long term. GRI is guided by the interpretation of the SDGs (Global Reporting Initiative, 2022), which refer in particular to two starting points:

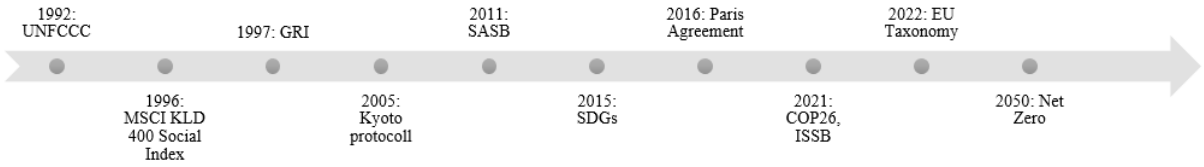
> (1) "Risks to people and the environment: the contribution every company can make to achieving the SDGs by meeting its responsibility to address potential and actual negative impacts to people and the environment linked to its operations and value chains." (United Nations Global Compact, GRI, 2018).
> (2) "Beneficial SDG-related products, services and investments: the additional contribution that companies can make to achieving the SDGs by applying their knowledge, skills and other capabilities to benefit people and the environment." (United Nations Global Compact, GRI, 2018).

These starting points can also be found in other approaches to SDG reporting for companies, such as in UN Principles for responsible investment (PRI & PWC, 2017) and rating agencies (Novethic, 2018).

Regulatory and incentive measures thus encourage companies to operate sustainably. "Through the EU Taxonomy, private investment should be steered towards activities necessary to achieve climate neutrality." (European Commission, 2022). In this context, the EU Taxonomy acts as a uniform, science-based transparency tool for companies and investors in the form of a classification system. The taxonomy aims to avoid greenwashing - a strategy by which actors seek to create an image of ecological responsibility through the targeted dissemination of disinformation -, to create transparency as to which activity contributes significantly to an environmental goal, and to channel public and private financial flows into sustainable, especially CO2-neutral investments. Water/sea protection, circular economy, pollution, and biodiversity/ecosystems will be integrated as additional targets in 2023. Thus, the EU taxonomy for the concept of sustainability creates clear rules and frameworks for when a company operates in a sustainable or environmentally friendly manner. In this way, these companies stand out positively from their competitors and should benefit from higher investments. This is intended to provide a binding answer to the question: When does a company operate sustainably? To better address this issue in the future, the EU has created a norm for global sustainability reporting standards. Companies will be subject to independent auditing and certification to ensure they provide accurate information. Investors will access comparable and trustworthy data, and sustainability and financial reporting will be treated equally (European Parliament, 2021). "Europe is showing the world that it is indeed possible to ensure finance, in the narrow sense of the word, does not govern the entire global economy." (Durand, 2022).

Figure 3

Development of SRI (own representation, based on MSCI, SASB, Refinitiv Datastream and IMF staff)



2.3 Environmental, Social, and Governance

The letters ESG describe the three sustainability-related areas of corporate responsibility: environmental, social, and governance. They are intended to be integrated into a company to increase its goodwill appropriately. The various criteria from these three areas can be used to evaluate a company's sustainability.

ESG performance and CSR are two related but slightly different concepts. CSR includes only the first two ESG performances, a company's environmental and social practices. Corporate governance performance, with environmental and social impacts, is only integrated by ESG. Simplified, ESG, therefore, means CSR plus governance. ESG investments are long-term and consider a broad, though often differently interpreted, range of social and environmental issues. Environmental factors focus on preserving the natural world. Issues such as rising global warming, greenhouse gas emissions, and increasing energy and water consumption are addressed. Social factor focuses on social aspects, such as human rights and working conditions, to create a healthy and safe workplace. Governance stands for responsible corporate management and intends sustainable corporate management and resource planning. It can be viewed as a set of guidelines or principles that guide the rights, responsibilities, and interests of various stakeholders in corporate governance (Viviers & Eccles, 2012).

As mentioned in the previous paragraph, climate plays a vital role in the environmental part of the ESG ratings and is the one aspect most likely to be standardized. Accordingly, many sustainability funds focus exclusively on the environmental side of ESG in their allocation. One possible reason for this is that the environmental criteria of companies are more accessible to identify and operationalize than social or governance factors. In addition, climate change mitigation has been an ever-increasing important topic of public debate, at least since the Paris Agreement of 2016. The coronavirus pandemic, for example, has highlighted Social from a partially shadowy existence by highlighting social imbalance. Governance has also recently been brought into public focus by the Wirecard scandal for inadequate corporate monitoring (Hartwill, Rontaler, & Firth, 2021). A more holistic approach is required to meet global

sustainability goals (Götz, 2021). Decision-making processes that use environmental, social, and governance criteria to evaluate investments are called ESG investments.

2.3.1 ESG Scores

An ESG score is an objective measurement or evaluation of a particular company, fund, or security performance. It measures the impact of a company's sustainable actions on its external environment and how they affect the company.

The non-existent standardization of all ESG subcategories indicates that a precise delineation of relevant indicators and the associated concept of sustainability is impossible. Defining a detailed, generally applicable catalog of criteria or indicators is difficult or even impossible and unreasonable. Resulting mainly from a lack of shared understanding of what corporate responsibility should be in the three pillars of sustainability (Bassen, Jastram, & Meyer, 2005). A company's contribution to global warming and compliance with the 1.5 degrees Celsius target can be interpreted differently, leading to different results. A constant validation of different findings and assessment procedures of ESG rating agencies tries to address this problem (Scalet & Kelly, 2010).

2.3.2 ESG Rating Agencies

As ESG ratings can be an essential foundation for most types of sustainable investments, the market for ESG ratings grew parallel with sustainable investments (Berg, Kölbel, & Rigobon, 2022). Similar to how credit ratings allow investors to screen companies for their creditworthiness, ESG rating firms provide a mechanism to screen and rate companies for their ESG performance. The exact number of ESG rating agencies currently in existence is difficult to ascertain due to solid market fluctuations. It also varies depending on the definitional orientation: the structure of the organization in charge, the rating objects, the sources of information considered, the different focus areas, the rating methodology used, the regional scope, and the objective or intended purpose of the rating, which is taken into account when characterizing ESG ratings (Sadowski, Whitaker, & Buckingham, 2010).

Table 1

Differentiation of ESG Ratings (own representation, based on Sadowski, Whitaker, & Buckingham, 2010)

Differentiation	Example
Organizational structure	A non-governmental organization (NGO), a public company, an index provider
Rating objects	Companies, countries, products
Information source	primary or secondary data, internal or external sources
Focus areas	Environmental, social, governance, ethics
Rating Methodology	*depends on the rating agencies*
Regional scope	Europe, Asia, America, Africa, Emerging Markets, International
Objective purpose	On-demand, voluntary

Currently, an EU statistic lists 59 active providers (ESMA, 2022).

A conflict of interest can occur if the rated companies act as clients for the rating in relation to the rating agencies. The neutrality of the rating can thus be questioned. The better known and more renowned a rating or index is, the greater the interest and, consequently, the willingness of companies to pay for a rating (Dembinski, Bonvin, Domen, & Monnet, 2003). Rating agencies have developed measurement systems and criteria to evaluate companies' sustainability (Staub-Bisang, 2011). While credit ratings are based on precise data and predictable numbers, ESG ratings are subject to much greater discretion. These make it difficult for investors and financial institutions to understand the premises used by the rating agency. As a result, some banks are basing their decisions on in-house analysis, creating a new approach that differs from standardized criteria. Accordingly, the rating of an investment can vary depending on the provider. The following chart shows the correlations between ESG ratings at the level of an overall ESG view and a focused view using a common sample. The information that decision-makers receive from ESG rating agencies is relatively insufficient.

Table 2

Correlations between ESG ratings (own representation, based on Berg, Kölbel & Rigobon, 2022)

	KL SA	KL VI	KL RS	KL A4	KL MS	SA VI	SA RS	SA A4	SA MS	VI RS	VI A4	VI MS	RS A4	RS MS	A4 MS	Average
ESG	0.53	0.49	0.44	0.42	0.53	0.71	0.67	0.67	0.46	0.7	0.69	0.42	0.62	0.38	0.38	0.54
E	0.59	0.55	0.54	0.54	0.37	0.68	0.66	0.64	0.37	0.74	0.66	0.35	0.7	0.29	0.23	0.53
S	0.31	0.33	0.21	0.22	0.41	0.58	0.55	0.55	0.27	0.68	0.66	0.28	0.65	0.26	0.27	0.42
G	0.02	0.01	-0.01	-0.05	0.16	0.54	0.51	0.49	0.16	0.76	0.76	0.14	0.79	0.11	0.07	0.30

Notes. KL, SA, VI, RS, A4, MS are short for KLD, Sustainalytics, Vigeo Eiris, Asset4, MSCI

The chart shows that ratings from different providers differ significantly. Correlations between ratings range from 0.38 to 0.71, with an average correlation of 0.54. Accordingly, it is questionable whether increased ESG disclosure can lead to further inconsistencies (Berg, Kölbel, & Rigobon, 2022).

The rating agencies' business model is no less controversial, as the best-known and largest agencies operate as for-profit companies. Fears that profit orientation could harm the quality and objectivity of ratings have led to considerations in the direction of state-funded and foundation models (Hiß & Nagel, 2012).

In addition, there is a risk with financial ratings that companies could change agencies if dissatisfied with the rating. On the other hand, opponents of this fear argue that favoritism ratings will be exposed in the long run, leading to declining acceptance of the agency and even depriving of its business basis (Jäckle & Ackermann, 2007). Objective, high-quality ratings are consequently not only in the interest of customers and companies but also of rating agencies in particular (Jäckle & Ackermann, 2007) (Hiß & Nagel, 2012).

It is important to note that investors cannot rely on all ratings; instead, a selection must be made. However, as it is difficult for an investor to find a suitable rating to identify sustainable companies due to the non-transparency of the methodologies, they can still serve the purpose of a warning signal for poor ESG performance and stimulate further research.

Given a lack of shared understanding of sustainability, it is, therefore, crucial that a rating agency justifies and communicates precisely why and how specific indicators are rated and what goal and purpose are being pursued by doing so (Chatterji, Levine, & Toffel, 2009). The largest ESG rating agency, MSCI, is accused in an article published on Bloomberg of not trying to measure a company's impact on the world. It would only be concerned with whether the world could affect the profits of the rated companies (Cam, Akshat, & Saijel, 2021).

In general, however, given the increasing relevance of ratings and the resulting positive growth prospects for the SRI market (Eurosif, 2012), it is likely that ESG ratings will need to evaluate companies to determine their willingness to pay - regardless of the outcome - will increase in the future.

2.3.3 ESG Strategies

Various strategies exist for considering investments in terms of their sustainability. The most well-known screening approaches are positive, negative, and best-in-class ESG Screening. Positive screening is the active selection of potential sectors or companies based on preferable characteristics in terms of their sustainability or meeting set performance metrics. Investors who engage in positive screening first select an issue - such as pursuing one of the SDGs - to

influence and then determine how to best measure a company's performance in that area. If a company ranks among the best in its industry, it is considered positively screened according to the best-in-class principle. Negative screening excludes specific sectors. They might not meet predetermined moral and ethical standards and ESG criteria, such as sectors considered harmful, like arms manufacturers or gambling. Value-oriented investors mainly use it by incorporating their values. Some investors use negative screening based on a company's behavior concerning certain internationally recognized norms. For example, unlike in Germany, nuclear energy is classified as sustainable in France. Also known as the divestment approach, the strategy in such cases even goes as far as selling holdings in specific industries. Eliminating fossil fuel investments from portfolios is becoming increasingly significant as prominent asset managers seek to align their portfolios with the Paris Agreement and the 1.5 degrees Celsius target, which requires reducing the carbon intensity of their investments.

Many investors now use both approaches, screening out stocks they morally oppose and proactively selecting the best stocks that make a difference in areas vital to them (Cappucci, 2018).

2.3.4 ESG Challenges

Sustainable investments are in a grey area due to a lack of definitions. The lack of standardization and transparency makes it difficult for investors to compare different ESG scores and understand them. In addition, more ESG data needs to be available to lead to adequate and reliable statements. Organizations and frameworks such as the GRI, the EU Taxonomy, and the SASB show that there is yet to be a clear global standard for ESG reporting, only a lot of regional or industry-specific approaches. ESG risks are challenging to measure because many are not quantifiable. If experts barely understand them, how can investors understand the report and make an informed statement about their investment?

> "All elements of ESG reporting are really based on proper risk management. You can't manage your risk if you don't know what your risk is." (Porco, 2021).

The difficulty for investors and other interested stakeholders, such as NGOs, now lies in verifying the data and information published in corporate reports, on websites, or otherwise, and enabling comparison on a company-by-company basis (Schneider & Meins, 2012). However, companies present themselves as positively as possible to the public. This can lead to deliberately controlled falsification of reports. This behavior is subsumed under the term greenwashing (Schaltegger, 2012). One of the companies' goals is to increase their attractiveness to potential customers with parallel developing profitability. Generation Z, in particular, spends more money on companies that are perceived to be ethical. However, 73

percent of Millennials would also pay more for a product from a company that operates sustainably (Riccolo, 2021). Consequently, companies are financially incentivized to act or look more socially conscious. An Oxford University study has shown that the financial loss of the divestment campaign - the fastest in history - will not be felt through the shares sold but through the loss of reputation of these companies due to their stigmatization.

Using unprotected terms such as *environmentally friendly* or *climate-friendly* is also increasingly misleading investors (Brzinzky, 2011).

Given these weaknesses, the ratings' practical mission of providing interested investors with relevant information for their investment decisions needs to be more adequately fulfilled. With further irregular growth in the rating methodologies, no additional benefits are currently being generated; the published data tend to create confusion and uncertainty (Sadowski, Whitaker, & Buckingham, 2010). The resulting loss of trust, the complexity of ESG products, and possible reputational damage can, in the worst case, even lead to refraining from investing in actually sustainable companies (Chatterji, Levine, & Toffel, 2009) (Windolph, 2011).

2.3.5 ESG Opportunities

SRI is increasingly vital for avoiding negative social and or environmental impacts. The evolution from a niche product to a mainstream investment is helping SRI gain importance and scale (Sparkes & Cowton, 2004). The main reasons for integrating ESG into investment decisions include 52 percent improved long-term returns, 47 percent brand image and reputation, and 37 percent reduced investment risk (Romero, Jeffers, Beixin, Aquilino, & DeGaetano, 2018). The resulting increase in customer demand for ESG-focused products accordingly increases the number of customers, as well as the growth or success of the company. Acting according to standards of good corporate governance shows better performance in the long term. For example, emissions reductions provide cost savings. Companies that comply with regulatory requirements can also receive subsidies. Jobs of value increase employee productivity and satisfaction.

Nevertheless, societal pressures resulting from a growing awareness of social and environmental issues have also driven the development of ESG investments, whether in terms of products or corporate activities per se. This development works to the extent that companies want to be associated with positive reporting or ratings (Windolph, 2013). The reputation of a company is improved. Also, adverse public events (environmental, employee, management grievances) that can harm a company's performance and lead to high volatility are lower for companies with a stronger ESG focus. These reasons also provide a competitive advantage and thus create long-term value for stakeholders. Another opportunity of ESG investments,

compared to traditional investments, is improved risk management. Companies that pay attention to sustainability in general act in a more forward-looking manner and thus perform with less risk (Starica, 2008).

With sustainable financial products, financial institutions are meeting the demands of new generations, as generations such as Millennials and Generation Z are more aware of global sustainability challenges. Wealth managers can better meet the needs of different market segments by offering new products and services - adapted to the new expectations of future customers. Companies can turn the management of their environmental impact into a competitive advantage. Herd behavior is particularly evident in financial markets, meaning market participants tend to make the same decisions as other market participants (Serafeim, Kotsantonis, Saltzman, & Ward, 2017).

From an investor's perspective, incorporating ESG factors can reduce overall volatility risk. Risk is spread through optimized asset allocation. A focus on long-term investments seems more reasonable than the mentality in favor of short-term financial returns that still often prevails. While sustainable investments have been mistakenly viewed as a source of poor returns, numerous studies show that ESG investments have generated similar returns or outperformed traditional funds (Hvidkjær, 2017). Morningstar compared nearly 4,900 European-based funds in a report published in 2020 and found, among other things, that over ten years to 2019, nearly 58.8 percent of sustainable funds still on the market outperformed their average outlasting traditional counterpart in the categories considered (Morningstar, 2020).

Numerous independent studies have confirmed the connection between ESG criteria, the success of a company or its performance, and a possible reduction in risk. Accordingly, sustainable investments are seen as an investment for the future.

2.4 Potential Literature Gap

Although academia has already produced numerous studies on ESG metrics and ratings, little attention has been paid to their fundamental importance and the support they provide to investors. In research, the following studies already exist:

The European Securities and Markets Authority (ESMA) found in the February 2022 *Call for Evidence* report on the market structure for ESG rating providers in the EU that users of ESG ratings seek ratings from multiple agencies simultaneously. Reasons for this are to increase coverage either by asset class or geography, thus obtaining different results. The insufficient granularity of data and a lack of transparency regarding the methodologies used for the ESG score were identified. However, it was also recognized that ESG ratings are increasingly being

provided based on payments made by the issuer. Companies covered by ESG ratings devote at least some resources to their interactions with ESG rating providers, although the extent depends mainly on the size of the rated company itself. Most respondents pointed out deficiencies in their interaction with rating providers, particularly regarding the level of transparency regarding the basis for the rating, the timing of feedback, or the correction of errors. ESMA would like to continue to support the European Commission in assessing the need to introduce regulatory safeguards for ESG ratings.

According to a collected study - consisting of three individual studies - on the unresolved issue of the link between values and behavior, it was found that, in particular, the increasing awareness of investors for concerns in areas such as the environment, employees, or product safety has contributed to the continuous growth of such investments, in which non-financial criteria were taken into account. However, numerous studies have yet to disprove a connection between the consideration of non-financial criteria and poorer investment performance. The growing media attention for the topic or the increasing number of sustainability indices are among the main drivers of this development. Legal developments in this area, such as the EU taxonomy, should be addressed, too (Bardi & Schwartz, 2003).

According to a survey by Eurosif, demand for SRI is increasing significantly, especially in Europe and Canada (Eurosif, European SRI Study, 2008). Europe continues to lead the world with 49 percent of all Asset under Management (AuM), followed by Africa (35.2 percent), Canada (20.2 percent), Australia/New Zealand (18 percent), and Asia (35.2 percent) (Global Sustainable Investment Alliance, 2013). The 2012 Eurosif study and the most recent 2014 study show more robust growth in SRI strategies than in total AuM invested in Europe (Eurosif, European SRI Study, 2012).

Furthermore, 63 percent of 700 sustainability experts surveyed said they believe the influence of relevant ratings on corporate sustainability performance will increase within the next three years (SustainAbility, 2014).

The gaps, in theory, need to go further and give reason to explore this contrary topic further

2.5 Hypotheses Formulation

The growing literature on CSR and the increased demands for implementing sustainable change has shown a growing recognition of the role of business in society. Negative externalities created by corporate social investment have led to the conclusion that companies focusing solely on profit maximization act at society's expense. An ethical and philanthropic obligation to their stakeholders is therefore imposed on companies. In addition, legislators require companies to report on their ESG measures. While companies can report on their ESG activities in any way

they choose, laws will likely become more stringent in the coming years. The EU Taxonomy provides a preliminary classification system for environmentally beneficial activities to redirect funding in line with the EU Commission's 2030 energy and climate targets. It provides an outlook for more stringent regulations in the future. The benefits of a solid corporate social performance (CSP), such as better performance in gaining and maintaining market share, avoiding risks and costs associated with socially irresponsible behavior, and accessing finance, provide intrinsic motivation to recognize the growing importance of ESG considerations (Eccles, Ioannou, & Serafeim, 2014). Based on these considerations and the gaps listed in Chapter 2 regarding the validity of ESG ratings, the following research question can be derived:

How can ESG data truly validate its significance?

As a premise, this master thesis focuses exclusively on the EU, including its rules and regulations.

3. Methodological Concept

The research methodology used for the empirical validation of the research question consists of five steps: Defining the research idea and research problem, creating the research design, selecting the data collection method, data sample, and data analysis procedure, as shown in Figure 3 (Kaya, 2009):

Figure 3

The research methodology approach (own representation, based on Kaya, 2009)

3.1 Research Idea and Research Problem Definition

First, a research problem must be defined based on the research idea. As already shown in chapter 2, a literature review serves as a basis to define the research problem. It is an iterative process that attempts to find gaps in the existing literature (Döring & Bortz, 2006). It provides the theoretical basis for formulating a research objective. The research objective attempts to solve the research problem. Based on the state of the literature and the formulated research objective, a solution approach in the form of a research question has to be defined.

3.2 Research Design

The research design provides a guideline that serves as a structural pattern. There are three research designs: exploratory, descriptive, and causal. Exploratory research involves gaining ideas and insights in areas where more research needs to be done. It is primarily used to understand the relationships between different variables. In contrast to exploratory research, descriptive and causal research results can be described as statistically conclusive (Stein & Mankowski, 2004). Both approaches use quantitative analysis and large samples to arrive at results. Descriptive research focuses on different variables and describes their characteristics, while causal research focuses on the relationship between them (Homburg, 2020).

A distinction is further made between qualitative and quantitative research depending on the research question. The qualitative research method can explore new things in detail and deepen the understanding of subjective perceptions and actions from different perspectives. Qualitative approaches share a broad philosophy, such as person-centeredness in the form of experts and a particular open-ended starting point (Holloway & Todres, 2016). Experts are characterized by

having specific experiential knowledge from practice that is not already available in written form and can be elicited in the interview. In quantitative research, one forms as large a sample as possible to obtain much standardized information. Consequently, the present research project was examined to determine which approach is more suitable for eliciting meaningful results, and an explorative, qualitative approach was deliberately chosen. Therefore, no further consideration will be given to the quantitative approach in the remainder of the study.

As a research type, content analysis is used in qualitative research. Content analysis is frequently used as a text analysis strategy (Powers & Knapp, 2006). It is a systematic method of coding and categorizing data in which large amounts of textual information are examined to identify trends and patterns in words used, their frequency, relationships, and the structure and discourse of communication (Pope, 2006) (Mayring, 2000). The purpose of content analysis is to characterize the content of a document – in the present work using interviews - by examining who says what, to whom, and with what effect (Bloor & Wood, 2006). This approach helps answer questions such as: What events do people care about? What are people's reasons for using or not using a service or procedure? (Leaper & Ayres, 2007). Content analysis is well suited to analyze and simultaneously quantify the multilayered, important qualitatively, and sensitive phenomena (Gelbrich, 2007) (Elo & Kyngäs, 2008).

3.3 Data Collection Method

The research topic is prepared by forming a category system to answer the guiding question. The relevant research questions are derived with the help of the category system. From the research questions, the interview is extracted to obtain the necessary data. After sufficient literature research on the research topic, five categories have emerged. Since the individual categories are of equal importance and have no connections or subcategories, they are referred to as a linear category system (Appendix A).

Two to three interview questions will be developed per category to cover a broad range of individual topics. A semistructured guided interview will be chosen to obtain consistent information that fits the research question but to be able to act flexibly within the questions. The order of the questions remains variable so that they can be asked contextually, and the interviewer can react spontaneously to new information. Guiding questions serve as a common thread in the interview process, although as a framework, they should not represent a restriction. The focus should be on self-communications that are as uncensored as possible that is unadulterated. For this reason, suggestive questions should be avoided, as these already push the interviewee in one direction and could falsify statements. The openness of the

interview style leaves both questioner and interviewee room for active participation in the interview process. Aspects that seem essential can be questioned more strongly and allow further conclusions to be drawn about the interviewee's attitude regarding the research topic. There are no restrictive guidelines for the answers. The researcher created the underlying guideline and served as a guide to a uniform procedure, which should ensure openness and flexibility. This way, perspectives that arise during the interview can also be considered (Baur & Blasius, 2014).

3.4 Data Sample

A small number of cases defines the sample to obtain high-quality statements and data, including only eight interview partners (IP) from four EU countries. Some specifications were made to collect a suitable sample and allow targeted analysis. The questionnaire was addressed to employees of financial institutions and consulting companies for whom the ESG topic is part of their daily professional tasks. The selection of the data sample (Appendix B) was made freely by the researcher. All elements that could allow conclusions about the person of the respondent are deleted or anonymized in the further process. Examples of such elements are names and unique characteristics that could identify the person. The measurement is not standardized but refers to detailed data collection. A given sample is used to infer the population and generalize the results. The interviews were conducted between October 26, 2022, and November 5, 2022.

3.5 Data Analysis Procedure

The interview material (Appendix C) is evaluated using qualitative content analysis, according to Mayring (Mayring, 1994). The content analysis aims to break down the statements into relatively small content units so they can be subjected to descriptive treatment (Sparker, 2005). The scientific procedure ensures the method's comprehensibility, intersubjectivity, and transferability. Following the interviews, the respective data material is transcribed (available upon demand). Transcription means precise and verbatim reproduction of what was said during the interview with the help of a recording device. After the interview has been transcribed, related units are coded. Coding means collecting codes to categorize the IP's statements thematically. The goal of coding is to identify relevant text passages regarding the research question and then analyze them.

By coding, data material can be reduced - to make it more transparent - but loses its diversity of meaning. Subsequently, the data material was systematized according to the categories developed. For the evaluation of the interviews, statements were bundled. The result is a table with the coded categories and summaries, which makes a comparative interpretation possible in the next (Bloor & Wood, 2006).

4. Data Analysis

4.1 Presentation of the Results

The results of this master's thesis are intended to provide a guiding consideration for a critical examination of the topic, from which general conclusions can be drawn.

(1) Challenges

The following challenges were identified on the results of the interviews: Seven of the ten interviewees cited the lack of data availability and the often associated insufficient data quality as the main challenge for sustainable investments. Sampling across different industries showed that criticism of ESG ratings could focus on very different points depending on the individual profession. For example, interviewees from certain areas criticized the lack of sufficient qualitative data, while others complained about a lack of legal regulations.

IP1 criticizes that the problem with the ratings already lies in the missing and insufficient data. It is impossible to understand how the data is compiled and on what basis it was calculated to make a final assessment. Unlike other regulated ratings with clear guidelines, ESG ratings are not regulated. IP2 first distinguished between the data sources, i.e., the data that companies report voluntarily, data that companies have to report, or a data source pool with public data from research institutes or industry analyses. Progress would be made if companies had to disclose even more. Sustainability should be implemented in the annual report and reporting, as is done elsewhere with financial indicators. In addition, public data is more difficult to obtain, especially in emerging markets. IP5 clarifies that the challenge is not the general lack of data but obtaining homogeneous data. According to IP7, the problem is not just getting data but how to apply that data to make decisions or take action: "what KPIs do we really need to decide where to make substantive changes?" However, independently reviewing companies is a tall order for the asset manager. The need for more transparency in the rating agency's approach is also mentioned as a critical challenge.

Six interview partners mentioned the lack of a definition of the term sustainability. It must be defined correctly and uniformly to classify products correctly. Another challenge mentioned was the different regulatory regimes across countries. The starting point of data companies' reports does not refer to any global or common standards for ESG reporting.

Meanwhile, IP2 clarifies that regulation does not help as much as expected. Many investors fundamentally want more of a framework for sustainable investing. Regulatory measures alone

do not imply structurally better outcomes. "That an investor says 2, 3, 4, 5 percent underperformance is perfectly fine for me, and the main thing is that I am invested sustainably; that will not work." Sustainable financial products must convince by achieving at least the same or even better performance. Looking at E, S, and G on an equal footing is essential. According to IP5, there is a stronger focus on environmental aspects because more data is available on these topics, and they follow a more homogeneous framework.

Meanwhile, companies need more social data in their annual reports. Thus, it is difficult to identify whether social factors are relevant to the company. Results and statistics may depend on whether a rating is conducted on behalf of the company as a paid service or by an independent institute.

According to IP7, investors know entirely well that something needs to be done but are often unsure of the steps to take further. The risk of not doing the right thing is a dichotomy here. However, IP2 says that only a small number of investors indicate to a financial institution that investments should be made based on their values. The problem here is complexity. The products have to be different from the standard and are subject to many different approaches, which makes it all the more difficult for investors to choose the right product. The real challenge here is that wealth management advisors can communicate the products from the providers in an understandable way. Objectivity and neutral reporting are essential. However, experts are hardly familiar with the topic modified by the taxonomy, which raises the legitimate question of how private investors are supposed to understand this and draw the correct conclusions from it. Moreover, they do not necessarily check where the data comes from and whether it is credible but use it unfiltered. The result can then be an investment decision based on false foundations that are less sustainable than the investor had planned.

From the point of view of the companies, the challenge is that it is more difficult to obtain financing if sustainability is inadequate. Contracts with suppliers may also not be concluded due to poor key figures. Naturally, this can also be seen as an opportunity to motivate companies to obtain capital more effortlessly and at a lower cost. In addition, only some companies could afford the effort to provide evidence of their sustainability. This can involve a not-inconsiderable financial outlay and requires a person or department with the appropriate expertise. A fundamentally poor ESG rating reflects negatively on all stakeholders and can be summed up well in the words of IP1. "A poor long-term ESG rating ultimately means that shareholders withdraw from the company, the share price suffers, stakeholders suffer, and then the vicious circle starts all over again." The company must become sustainable to remain competitive. The European

Investment Bank has declared itself a climate bank, so it will not lend to projects that harm the climate. IP3 believes that for companies, the opportunities and challenges are the same. He said that companies with more challenges do not look to the future and need help understanding how to turn those challenges into opportunities.

(2) Opportunities

As an opportunity, three interview partners mentioned that sustainability figures help analyze companies, which can help investors make targeted investments. According to IP4, the risk is also lower with sustainable investments and leads to better performance in the long term. In addition, the stronger focus on sustainable investments in investment advice shows that investors are more concerned with their financial investment and sustainability. Through the taxonomy, sustainability can be integrated more into the advice. As a result, more investors are looking at which companies they want to support with their money. ESG, he said, needs to be looked at as a kind of new risk measure, similar to how market or credit risks are looked at on the banking side. According to IP2, the advantage of this from an investor's point of view is to analyze, identify, mitigate and ideally avoid the risk. He gives the following example based on a car manufacturer:

> "The EU wants to ban combustion cars in the next 10-15 years, and then you have two options as a manufacturer: keep your business model, then the EU ban comes, then your business model is finished, or change your business model and convert products to electric vehicles to be able to continue to exist. This risk can be illuminated by ESG analysis."

IP5 also claims that climate risk is now an investment risk. The assumption is that sustainable investment represents an improved opportunity for future generations. Another benefit IP3 sees is that players in the financial industry can report on their journey to sustainability and their progress in different areas.

(3) Criteria

Different opinions were expressed regarding the criteria that must be met for an investment to be considered ESG-compliant. Three interviewees believe that everyone should define the criteria for themselves. IP6 mentioned that a fundamental differentiation between minimum standards and green or sustainable products would be helpful. According to IP5, a distinction between *promoting sustainability* and *being sustainable* is also essential. IP8 questions how uniform the criteria can be.

Moreover, it is questionable whether these criteria can be defined similarly across countries in the second step.

> "If I were to define something here in Europe, for example, and say that a company is environmentally friendly if its CO2 emissions are XY, would the Americans even be interested? How can I make the whole thing comparable?"

IP3 also complains that the criteria depend heavily on geographic location. On the one hand, there are already many regulations and requirements in Europe, so the criteria should be pretty straightforward. Greenwashing is difficult in Europe because of existing laws and will become more difficult in the future because of further legislation. Comparatively, in the United States, many issues are polarized and politicized. "It is more of a political fight, which I think is unfortunate because I think this should be above ideology." IP3 makes it clear that there is not a single political party in Portugal that is against sustainability. The EU is putting itself at the center of the revolution and pushing the agenda to fulfill such commitments. European Commission action plans have already established disclosures for sustainable financial products.

In addition, the criteria have also been criticized for being easier to measure in terms of environmental criteria than S or G. IP2 emphasizes that ESG metrics are about more than just climate because climate issues are just one part of Environmental. The individual letters are interdependent, and this interaction between the individual letters is high. Aspects other than climate issues need to be focused on more because if a company treats its employees badly and therefore scores poorly in G, it may be irrelevant whether the company acts positively on the climate side. According to an overarching analysis, the company should receive a poor rating.

According to IP7, the EU taxonomy is a starting point for ranking a sustainable or ESG investment. He considered it a check-the-bock scheme in the making and strongly critiqued that it would exclude innovations. The goal is for all companies to follow only one scheme because, currently, many investors create their system. However, having one's way of measuring leads to the fact that one can no longer compare "apples with apples". The important thing about the scheme is that no one can "cheat their way through". The idea is to catch those who break the rules and try to sell investments as sustainable or ESG compliant, which is entirely wrong. The criteria aim to help investors distinguish between greenwashing and truly sustainable investments.

(4) Meaningfulness

According to 4 of the interview partners, the informative value of ESG indicators is already at a reasonable level. The premise is that the necessary conditions must be met. The responsibility for compliance with the conditions lies not only on the providers but also on the companies. Conscientious criteria must be checked, such as where data comes from, who checks the company, and whether there is a plausibility check.

From the interviews, it can be concluded that we are theoretically already in what could be called a "perfect world". The EU has already gone very far in the direction of SRI, and there are good data and ratings available. "If you look at the sustainability world of three or five years ago, it is insane what has happened in that time." With these words, IP2 clarifies that Europe is already at a reasonable level and emphasizes that this is not the end of the road. Ideally, assessments should be carried out globally to improve meaningfulness. The differences between Europe, which is way ahead, and America, or the emerging markets, are still glaring.

One can speak of a lack of informative value if the conditions are not met. The criticism is that many ratings are based exclusively on estimated values and that investors, financial institutions, and companies need an overview of the method used. IP6, who has set up their analysis due to the lack of condition, summarizes this as follows: "no insight into which methodology these estimates are based on", "data that is not understood". IP1 emphasizes that there needs to be a better informative value because the rating depends on who rates the company, and there is no concrete overview of how to achieve a good rating. Also, with the help of greenwashing measures, many companies present themselves as sustainable, while they are not at all. The fact that this is possible confirms the inadequate informative value. Even the exclusive pursuit of a good rating for one of the three letters leads to a positive rating, although S and G are entirely disregarded.

The question arises as to what is to be stated or measured. ESG indicators do not measure sustainability, as they were not designed for this purpose. What is measured is a risk, which explains why some companies are not sustainable by definition but have a high ESG score. Simply because they have low risk and are very transparent with their data, an oil company can also have a high ESG score but at the same time not be a sustainable investment.

The meaningfulness is also crucial in that some houses rely entirely on ratings. Asset managers build their indexes and fund compositions based on the ratings and pass them on to the end user - the investors. Using multiple rating providers can be considered to reduce dependencies, and varying results can lead to different assessments. Ratings depend on how each rating agency weighs companies' E, S, and G. To increase the meaningfulness of ESG metrics or ratings, IP7 says one does not need a complex method for calculating them. Instead, investors must develop a clear idea of their personal values. Then, the essential metrics could be derived from that to develop a strategy with a targeted approach. If one is talking about value-based investing, it is not recommended to invest in a product that usually does well but corresponds to the basis of other values - even if the financial performance would be high. "As long as you have a clear

idea of what your values are, the decision becomes very simple, and you do not need a very complex decision-making model with lots of KPIs or data points."

ESG ratings are a critical factor in future decisions. Nevertheless, increasingly, it will be necessary for companies to know how assessment results and conclusions arrived. Companies need guidance to understand what was rated, why and how, and what possibly could be.

(5) Trade-off

On the topic of conflicting objectives, all participants agreed that there is little to no conflict in the long term. Just as sustainable funds do not perform, there are also traditional - non-sustainable - funds that do not perform. Therefore, poor performance is not an indication that there is a conflict of objectives. The added expense of ESG investing is dealing with the products of different providers and working out one's criteria. In general, sustainable companies have lower long-term risks due to low volatility. The reason for this is rational risk controlling since sustainably operating companies plan.

Additionally, the interviews indicate that the ESG market might not be able to endure a trade-off. It is still possible to make a lot of money without sustainability, but this is expected to become increasingly complex in terms of competitiveness. IP3 claims that companies that are not sustainable are no longer attractive to investors but also to other stakeholders, such as the employees themselves. The following generations are unwilling to work in a company whose sole purpose is to generate profit. It makes them less attractive to the customer, which is increasingly represented among Millennials or Generation Z. With their purchasing power, they can determine who will make money in the future. In summary, IP3 believes that sustainability and making money will be part of the same equation.

IP7 raises the question of whether the idea of an unsustainable investment is even legitimate anymore. "How could we even consider doing something unsustainable and still believe that it will not negatively impact us in the long run, not even when money is involved." So if an investment does not make money, he said, should we stop investing in it again?

(6) Responsibilities

Seven of the eight interview partners think everyone is responsible for sustainable investments. Only IP8 claims that, in the end, the investor decides what he wants to invest. The other interview partners describe a holistic responsibility from the investor to the company to the legislator. All market participants have to face up to their responsibility in order to cope with tasks incumbent upon them. Sustainability can be distinguished between economy and ecology

and must be defined similarly. Regardless of whether focal points differ, neither economic sustainability without ecology nor vice versa is conceivable profitably in the long term. In addition, the same framework conditions must apply in every country. The fundamental question here is still, for whom sustainability is essential, what do the financial providers do for it, and does this come about on demand from the customer? IP8 explains from practice that many customers need to accept the topic in investment advice and find it completely uninteresting. What counts for many customers is whether one can earn money with it.

The investor must deal with the products intensively. The individual must inform himself to invest in SRI. Only in this way can it be ensured that the investment also flows into companies that promote sustainable projects. Together with the investment advisor, it must then be checked whether the strategy fits the wishes and values of the investor. The advisor thus acts as a middleman, considering the client's strategy on the one hand but being able to disclose the regulatory side. Companies must adapt their business models to fit the new environment and comply with regulations and consumer preferences. The task of the legislator is to set incentives. Otherwise, there is a danger that investments will only be made in financial products that bring the highest returns. Facilitating the flow of capital into sustainable investments and products must also be made more accessible. It is crucial to improve access to financial investments, regardless of whether they are large commercial investors or small private investors. However, especially in Europe, due to excessive bureaucracy, there is a risk that measures miss reality and does not even serve sustainability's primary goal. The main goal of sustainability is missed due to defensive reactions as a result of overregulation. However, interviewees also claim that companies such as BlackRock, the largest international asset manager, with their name recognition, also serve as role models for many investors and companies. According to IP3, BlackRock can push investors toward greater sustainability.

> "Fink, as CEO of the largest mutual fund in the world, has already understood that he sees things before we do and therefore has understood before we do. Companies that do not become sustainable will be less profitable and therefore cannot invest in companies that are not ready to become sustainable because they will lose customers and investors and consequently are not part of the future."

Larry Fink understood his responsibility to customers and society that the world is changing. Society is no longer willing to pay for externalities that companies cause, such as CO2 pollution. Accordingly, he would know that companies will be less profitable if they do not change to become more sustainable. Such companies will no longer be invested in because they will lose profitability.

Through different screening methods, the responsibilities can also be assessed differently. The divestment method allows the cancellation of investments in companies that do not build up their corporate strategy following CSR. The question arises as to who is then responsible for this. All respondents emphasized that there are reasons for excluding companies but that this strategy avoids responsibility. Reasons for this strategy include effectiveness in industries generally hostile to the environment. A lot of pressure can be exerted on companies through targeted disinvestment and the withdrawal of capital and liquidity. Capital flows are fast, and therefore this leverage works drastically. Companies can also be made aware of their lack of a sustainability strategy.

It has also been shown that defining criteria by excluding certain companies is not applicable, as the consideration of *acceptable* industries needs to be more consistent. As an investor, one must ask oneself what responsibility or role one has. It is not only financial resources that have an impact. Existing investments, such as proxy voting, offer the opportunity to work with the company to pursue a new strategy toward CSR. It is much more important to look at what one can do oneself and what the company plans to do in the future. "Do you invest in companies that have low emissions and exclude those that have high ones, or do you invest in the high ones and accompany them on the way." In this context, co-determination in operations and control of management can lead to a focus on renewable energy Accordingly, companies that have yet to achieve a goal by the deadline, but are willing to move in that direction, can also be supported. However, IP7 questions whether this approach is too idealistic and wonders how many companies can be persuaded to change.

It is therefore also crucial to understand the companies. Many companies are actively adapting their corporate strategy, but the primary considerations are still - how to secure jobs and pay wages?

In light of the previously mentioned statements made by the IPs, the markets will likely decide which approach is the right one as they are best suited to do so.

4.2 Interpretation of the Results

From the participants' statements, the main challenge of ESG metrics lies in data availability and unclear data collection methods. In addition, a uniform definition of sustainability has yet to be included, resulting in multiple interpretations. A lack of cross-national regulation is also criticized. A transformation to a sustainable environment can only be realized with the involvement of all participants - especially regionally. Without America's involvement, two-thirds of the entire market, investors, and products would not be considered. The EU taxonomy is a step in the right direction, but only limited to the EU. In principle, the informative value of

ESG indicators is good - under certain conditions. It is essential that investors also have a clear idea of their values.

In summary, everyone should feel responsible for the topic, which is why strategies such as the exclusion method are not considered suitable. As an investor, one should support the company on its way to the Net Zero 2050 goal. Legislators should set a framework and verify that the data is presented accurately and objectively. Investors need guidance and the necessary education. On the positive side, there is a continuing trend towards sustainable thinking and action, even though exceptional market conditions - the Corona crisis, disrupted supply chains, and, above all, the Ukraine war with the impact of sanctions - have led to temporary reassessments of previous thinking on sustainability, especially in the energy sector. It will be interesting to see how these problems will continue in the future and how other countries and regions will deal with the matter. Furthermore, the goal must be to anchor sustainable investments as a corporate purpose and thus convey additional meaning to the company beyond the mere purpose of making money. These ideas must positively influence all stakeholders.

In this work step, the basic theoretical assumptions named in chapter 2 are examined in more detail concerning their practical relevance. The basis for this is the interview statements summarized earlier.

It emerged from the interviews and the theoretical basis that ESG indicators need to provide a general statement on the definition of sustainability. The lack of standardization of ESG metrics and the associated divergence of results makes it difficult to say how sustainable investment decisions should be evaluated and can lead to inconsistencies in the evaluation. Moreover, it needs to be determined whether what is supposed to be measured is actually measured. Accordingly, the question for investors is which metrics and rating agencies are best suited for achieving the goal. A precise catalog of criteria or requirements at the level of reporting non-financial information must be in the interest of investors and analysts because this will increase standardization and the quality of reporting and create a basis for the comparability of corporate data.

In addition to the data quality, the question of the collected data type is at least as necessary. Especially chapter 2.1 *Regulation and state of the art in reporting,* shows how many decades various committees and systems have been trying to unify sustainable finance and how no specific system is available yet. The current EU taxonomy needs help, as it can only cover some relevant economic activities. As a result, the criteria still need to be clearly defined so they can be interpreted from different perspectives. In addition, companies still need to be required to report relevant financial data. Since internal procedures and metrics have yet to be fully adopted

and are not in line with the new taxonomy, it is difficult to determine whether companies benefit society or harm it significantly.

Driving influences such as societal pressure, policy, and regulation, and the long-term profitability of a sustainable business will continue to increase the demand for, and thus the identification of, investments in sustainable businesses. Raising society's awareness of environmental and social issues exposes companies to risks in the form of reputational damage or customer declines. For the successful implementation of the socio-political guiding principle of sustainability, which is based on the principle of voluntariness, the participation of companies as a significant group of actors is of decisive importance. Accordingly, they bear a share of the responsibility for achieving sustainability. In this sense, a company that integrates sustainability aspects into its strategy can be understood as a *transformation vehicle* that contributes to achieving societal or macroeconomic sustainability goals at the micro level. Regardless of the motives and attitudes toward investment, investors must consider sustainability in their strategy. Critical in this context is the often questionable objectivity of ESG ratings. The criticism voiced goes beyond traditional ratings, particularly in the following point. Against this background, the question arises regarding the validity, credibility, and, thus, ultimately, the legitimacy of ESG ratings.

Following Fink (Fink, 2021), this master's thesis shows that it is not a question of the extent to which a sustainable investment can serve a purpose. Any company, whether it has a sustainable strategy or not, must have an orientation toward creating long-term value and sharing it with all stakeholders who participate in it. For this reason, it is advisable to strive for a change from shareholder capitalism to stakeholder capitalism because to create long-term value; one has to work for all stakeholders.

4.3 Recommendation for Action

The limitations of this work are that it needs to answer which rating provides the best results from an investor's perspective. Furthermore, it needs to answer whether a uniform rating framework should be sought in the rating agency market so that products are rated differently by rating agencies in terms of their sustainability. Which rating is suitable for which investor could be determined by segmenting investor groups and ESG ratings. The subsequent use of ESG ratings to identify sustainable investment decisions is not ruled out by the results of this work and should be further explored in the future to guide investors. The sub-steps must always be considered in line with the respective investment strategy and further objectives, which is why the following exemplary procedure should be considered:

(1) *Defining the investment objective* - In ESG investing, investors pursue different objectives in identifying sustainability-oriented companies. It must be clear why a good ESG rating is being sought. While some investors look for companies that meet their ideals, others are oriented toward rational value added to society (Schueth, 2003). In addition, there may also be a purely monetary interest based on the assumption that sustainable companies create more financial value than their peers.

(2) *Selecting the suitable rating* - Once it is clear what the objectives of the investment decision are, an appropriate rating can be found. For example, investors who aim to combat climate change can use the Temperature Score to quantify the extent to which the company contributes to global warming through greenhouse gas emissions. Social and corporate governance are not explicitly considered. Sufficient transparency about the calculation method in data collection, weighting, and calculation is critical in the assessment.

(3) *Evaluating the results* - The results can be used in various ways. However, the findings of this work have shown that a performance indicator is by no means a sole characteristic of investment decisions. A rating agency's ESG score should therefore be validated by at least one other ESG score to serve as a first indicator to show a tendency of the sustainability situation of companies. A high rating difference or a negative rating can serve as a warning signal and trigger further investigations.

5. Conclusion

Climate change, increasingly extreme weather phenomena, a growing awareness of the finite nature of our resources, and increasing transparency of poor working conditions are just some drivers that have changed society's expectations of companies. Orientation to the new social standards is an existential issue for companies. These developments have led to a growing investor community that considers financial criteria and non-financial, so-called ESG indicators in investment decisions. A parallel market for ESG ratings has emerged to meet the resulting need for information.

This paper investigated the validity of ESG ratings. Based on eight expert interviews, the opportunities and risks of ESG scores and their ratings in investment decisions were investigated. Beginning with a short introduction and delimitation of CSR, SRI, and ESG, the emergence and development were reported on the current situation in the ESG rating market. Subsequently, according to Mayring, a qualitative analysis was applied with the help of the interviews. It builds on previous findings based on the interviewees' experiences.

Based on the results of this work, the initial quotation can be confirmed that the social responsibility of business is to increase profits only under the condition that these are seen not only in the monetary sense but in the form of satisfying all stakeholder requirements. To adequately address the problem described above, this study came to the following conclusion: To help investors make sustainable investment decisions, additional research needs to be done based on an analysis of the focus of each indicator, highlighting their weaknesses and strengths. Based on this, investors can use the metrics that are most appropriate for them. Accordingly, it is optional first to compare the calculation methods to verify the validity of the information. Thus, it remains an open question about which metric or rating can be used for which purpose. Although a general sustainability rating can be misleading, poor results will serve as a warning signal for ESG risks of individual companies and encourage investors to do further research. However, comparing the rating used by the investor with reports from other providers can validate statements to some degree, helping to build consensus on a company's sustainability rating.

ESG ratings play an important role in achieving climate goals such as climate neutrality in Europe by 2050 and not jeopardizing the needs of future generations.

6. Limitation

The results of this master thesis must be considered in the context of some limitations. The low validity due to the sample size used can be seen critically. The study's scope is thus limited and cannot necessarily be transferred representatively to the population or even generalized. There needs to be more than the conclusions drawn for a precise result. Extensive data set is recommended to ensure representativeness in the future. However, this is not feasible in the time frame envisaged for the present work. The fixation on the financial and consulting sector should also be viewed critically, as respondents are limited here. The limitation of the number of samples determines the inclusion of other sectors in so far as the resulting knowledge gap can lead to a distortion of the study.

Furthermore, qualitative research is characterized by a stronger focus on the research object. For the evaluation, an open and, at the same time, flexible approach is recommended in order to be able to adapt individually. However, the results can vary greatly and are difficult to summarize due to the diversity. Within the desired scope of this paper, it is hardly possible to include all aspects of the interviewees. In this case, a more substantial development of the evaluation technique is recommended.

During the elaboration of the present master thesis and the literature research, it became clear that an extension of this investigation to include the consideration and influence of the more detailed view and presentation of the approach of ESG ratings would be helpful. However, this consideration would go beyond this thesis's scope or have to be analyzed in a separate elaboration, although this topic is essential for investors when making investment decisions as well as for the companies themselves.

In addition, this work focused exclusively on the EU, so only on this basis laws and interview partners were evaluated. Considering the worldwide extent of ESG ratings could lead to other results. Only interview partners from four EU countries were considered, which cannot be considered representative of the 27 EU countries. It would be interesting to know whether there is a correlation between the countries of origin of the interviewees and their views on sustainability. However, this would have required interviewing more people from each country.

Regardless of the limitations of this paper, it makes a valuable contribution to improving knowledge about ESG ratings and lays a foundation for further research.

Appendix

Appendix A

Category system (own representation)

Category	Description
Challenges	Challenges of ESG Ratings
Opportunities	Opportunities for ESG Ratings
Criteria	Criteria to label an investment as ESG conform
Meaningfulness	Meaningfulness of ESG indicators
Trade-off	Trade-off between making money and investing responsibly
Responsibilities	Sustainability-related responsibilities

Appendix B

Sample overview (own representation)

Interview partner (IP)	branch/ profession	Country
IP 1	Consulting: Sustainability Data leader	Germany
IP 2	Multi-Asset Analyst	Germany
IP 3	President of a non-profit association (area of social responsibility and sustainability) as part of the European network of CSR Europe	Portugal
IP 4	Founder and Managing Partner of an ESG Investment Fund	Germany
IP 5	Director of an asset manager with an ESG Investing Certificate	Spain
IP 6	Responsible for Sustainability Communication and Strategy and Head of ESG Analyst Team	Germany
IP 7	Director of ESG & Sustainability at a sustainable real estate consulting firm	Netherlands
IP 8	Head of the department of a securities specialist center at a financial institution	Germany

Notes. Sample size = 8; anonymized names, industry/job of a participant in the study.

Appendix C

Interview guide: Questionnaire (own representation)

Participant Information:

Master Thesis Title: Identification of Sustainable Investment Decisions - Analysis for the Evaluation of the Validity of ESG Ratings

Researcher: Jennifer Schäfer

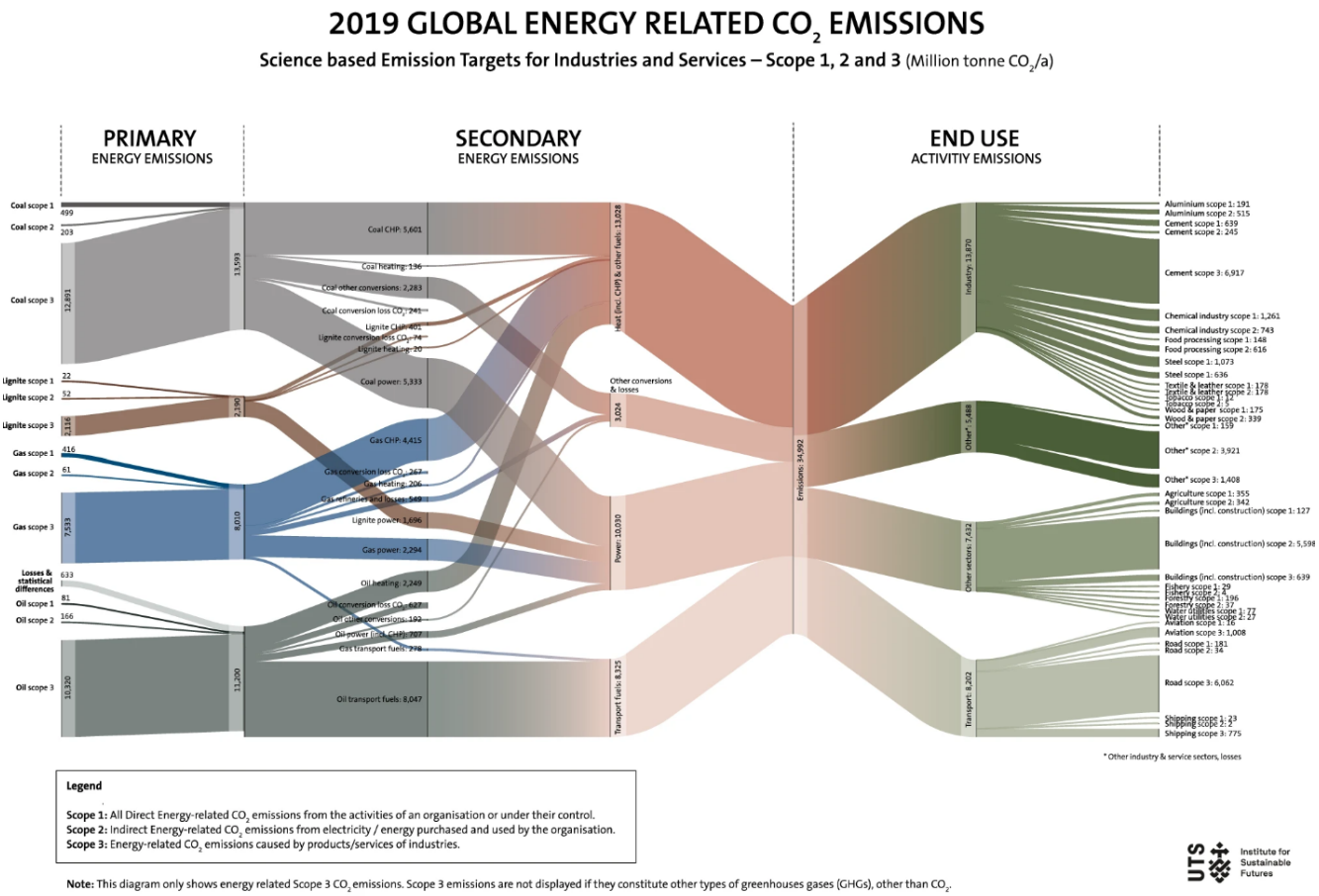
The data will be kept under lock and key and only the researcher will have access to it. All personal or personally identifiable data will be anonymized.

Questions:

1. what are the challenges and opportunities of sustainable investing?
2. what criteria must be met to label an investment as an ESG investment?
3. how do you rate the informative value of the ESG key figures?
4. how well do ESG metrics measure sustainability?
5. Why are ESG metrics relevant for investors?
6. what is the trade-off between making money and investing it responsibly?
7. how effective do you think divestment/exclusion is as a method of making a difference?
8. what advice do you have for investors who want to invest according to their values and do not want to invest a lot of time in research?
9. To what extent do you believe that sustainable investments can create purpose, such as making capitalism more sustainable?
10. "We focus on sustainability not because we're environmentalists, but because we are capitalists and fiduciaries to our clients." – Larry Fink's 2022 Letter to CEOs. According to Larry Fink, financial institutions should focus on sustainability because they are acting as fiduciaries for their clients. Who do you personally think is responsible for sustainable investing? (Laws, Investment Advisors, Investors)

Appendix D

Scopes 1,2, and 3 (Teske, et al., 2022)



Appendix E

REGULATION (EU) 2019/2088 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of November 27 2019 on sustainability-related disclosures in the financial services sector (EUR-Lex: EU law, 2019)
Notes. Extract of Article 6, 8 and 9.

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

(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 114 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Economic and Social Committee ([1]),

Acting in accordance with the ordinary legislative procedure ([2]),

Whereas:

(1) On 25 September 2015, the UN General Assembly adopted a new global sustainable development framework: the 2030 Agenda for Sustainable Development (the '2030 Agenda'), which has at its core the Sustainable Development Goals (SDGs). The Commission Communication of 22 November 2016 on the next steps for a sustainable European future links the SDGs to the Union policy framework to ensure that all Union actions and policy initiatives, both within the Union and globally, take the SDGs on board at the outset. In its conclusions of 20 June 2017, the Council confirmed the commitment of the Union and its Member States to the implementation of the 2030 Agenda in a full, coherent, comprehensive, integrated and effective manner, and in close cooperation with partners and other stakeholders.

(2) The transition to a low-carbon, more sustainable, resource-efficient and circular economy in line with the SDGs is key to ensuring long-term competitiveness of the economy of the Union. The Paris Agreement adopted under the United Nations Framework Convention on Climate Change (the 'Paris Agreement'), which was approved by the Union on 5 October 2016 ([3]) and which entered into force on 4 November 2016, seeks to strengthen the response to climate change by, inter alia, making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.

(3) In order to reach the objectives of the Paris Agreement and significantly reduce the risks and impacts of climate change, the global target is to hold the increase in the global average temperature to well below 2 °C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1,5 °C above pre-industrial levels.

(4) Directives 2009/65/EC ([4]), 2009/138/EC ([5]), 2011/61/EU ([6]), 2013/36/EU ([7]), 2014/65/EU ([8]), (EU) 2016/97 ([9]), (EU) 2016/2341 ([10]) of the European Parliament and of the Council, and Regulations (EU) No 345/2013 ([11]), (EU) No 346/2013 ([12]), (EU) 2015/760 ([13]) and (EU)

2019/1238 ([14]) of the European Parliament and of the Council share the common objective of facilitating the uptake and pursuit of the activities of undertakings for collective investment in transferable securities (UCITS), credit institutions, alternative investment fund managers (AIFMs) which manage or market alternative investment funds, including European long-term investment funds (ELTIFs), insurance undertakings, investment firms, insurance intermediaries, institutions for occupational retirement provision (IORPs), managers of qualifying venture capital funds (EuVECA managers), managers of qualifying social entrepreneurship funds (EuSEF managers) and providers of pan-European personal pension products (PEPPs). Those Directives and Regulations ensure the more uniform protection of end investors and make it easier for them to benefit from a wide range of financial products, while at the same time providing rules that enable end investors to make informed investment decisions.

(5) Disclosures to end investors on the integration of sustainability risks, on the consideration of adverse sustainability impacts, on sustainable investment objectives, or on the promotion of environmental or social characteristics, in investment decision-making and in advisory processes, are insufficiently developed because such disclosures are not yet subject to harmonised requirements.

(6) The exemption from this Regulation for financial advisers which employ fewer than three persons should be without prejudice to the application of the provisions of national law transposing Directives 2014/65/EU and (EU) 2016/97, in particular the rules on investment and insurance advice. Therefore, although such advisers are not required to provide information in accordance with this Regulation, they are required to consider and factor in sustainability risks in their advisory processes.

(7) Entities covered by this Regulation, depending on the nature of their activities, should comply with the rules on financial market participants where they manufacture financial products and should comply with the rules on financial advisers where they provide investment advice or insurance advice. Therefore, where such entities carry out activities of both financial market participants and financial advisers concurrently, such entities should be deemed to be financial market participants where they act in the capacity of manufacturers of financial products, including portfolio management, and should be deemed to be financial advisers where they provide investment or insurance advice.

(8) As the Union is increasingly faced with the catastrophic and unpredictable consequences of climate change, resource depletion and other sustainability-related issues, urgent action is needed to mobilise capital not only through public policies but also by the financial services sector. Therefore, financial market participants and financial advisers should be required to disclose specific information regarding their approaches to the integration of sustainability risks and the consideration of adverse sustainability impacts.

(9) In the absence of harmonised Union rules on sustainability-related disclosures to end investors, it is likely that diverging measures will continue to be adopted at national level and different approaches in different financial services sectors might persist. Such divergent measures and approaches would continue to cause significant distortions of competition because of significant differences in disclosure standards. In addition, the parallel development of market-based practices that are based on commercially-driven priorities that produce divergent results currently causes further market fragmentation and might even further

exacerbate inefficiencies in the functioning of the internal market in the future. Divergent disclosure standards and market-based practices make it very difficult to compare different financial products, create an uneven playing field for such products and for distribution channels, and erect additional barriers within the internal market. Such divergences could also be confusing for end investors and could distort their investment decisions. In ensuring compliance with the Paris Agreement, there is a risk that Member States adopt divergent national measures which could create obstacles to the smooth functioning of the internal market and be detrimental to financial market participants and financial advisers. Furthermore, the lack of harmonised rules relating to transparency makes it difficult for end investors to effectively compare different financial products in different Member States with respect to their environmental, social and governance risks and sustainable investment objectives. It is therefore necessary to address existing obstacles to the functioning of the internal market and to enhance the comparability of financial products in order to avoid likely future obstacles.

(10) This Regulation aims to reduce information asymmetries in principal-agent relationships with regard to the integration of sustainability risks, the consideration of adverse sustainability impacts, the promotion of environmental or social characteristics, and sustainable investment, by requiring financial market participants and financial advisers to make pre-contractual and ongoing disclosures to end investors when they act as agents of those end investors (principals).

(11) This Regulation supplements the disclosure requirements laid down in Directives 2009/65/EC, 2009/138/EC, 2011/61/EU, 2014/65/EU, (EU) 2016/97, (EU) 2016/2341, and Regulations (EU) No 345/2013, (EU) No 346/2013, (EU) 2015/760 and (EU) 2019/1238 as well as in national law governing personal and individual pension products. To ensure the orderly and effective monitoring of compliance with this Regulation, Member States should rely on the competent authorities already designated under those rules.

(12) This Regulation maintains the requirements for financial market participants and financial advisers to act in the best interest of end investors, including but not limited to, the requirement of conducting adequate due diligence prior to making investments, provided for in Directives 2009/65/EC, 2009/138/EC, 2011/61/EU, 2013/36/EU, 2014/65/EU, (EU) 2016/97, (EU) 2016/2341, and Regulations (EU) No 345/2013 and (EU) No 346/2013, as well as in national law governing personal and individual pension products. In order to comply with their duties under those rules, financial market participants and financial advisers should integrate in their processes, including in their due diligence processes, and should assess on a continuous basis not only all relevant financial risks but also including all relevant sustainability risks that might have a relevant material negative impact on the financial return of an investment or advice. Therefore, financial market participants and financial advisers should specify in their policies how they integrate those risks and publish those policies.

(13) This Regulation requires financial market participants and financial advisers which provide investment advice or insurance advice with regard to insurance-based investment products (IBIPs), regardless of the design of the financial product and the target market, to publish written policies on the integration of sustainability risks and ensure the transparency of such integration.

(14) A sustainability risk means an environmental, social or governance event or condition that, if it occurs, could cause a negative material impact on the value of the investment, as specified in

sectoral legislation, in particular in Directives 2009/65/EC, 2009/138/EC, 2011/61/EU, 2013/36/EU, 2014/65/EU, (EU) 2016/97, (EU) 2016/2341, or delegated acts and regulatory technical standards adopted pursuant to them.

(15) This Regulation should be without prejudice to the rules on the risk integration under Directives 2009/65/EC, 2009/138/EC, 2011/61/EU, 2013/36/EU, (EU) 2016/97, (EU) 2016/2341, and Regulations (EU) No 345/2013 and (EU) No 346/2013 and as well as under national law governing personal and individual pension products, including but not limited to the relevant applicable proportionality criteria such as size, internal organisation and the nature, scope and complexity of the activities in question. This Regulation seeks to achieve more transparency regarding how financial market participants and financial advisers integrate sustainability risks into their investment decisions and investment or insurance advice. Where the sustainability risk assessment leads to the conclusion that there are no sustainability risks deemed to be relevant to the financial product, the reasons therefor should be explained. Where the assessment leads to the conclusion that those risks are relevant, the extent to which those sustainability risks might impact the performance of the financial product should be disclosed either in qualitative or quantitative terms. The sustainability risk assessments and related pre-contractual disclosures by financial market participants should feed into pre-contractual disclosures by financial advisers. Financial advisers should disclose how they take sustainability risks into account in the selection process of the financial product that is presented to the end investors before providing the advice, regardless of the sustainability preferences of the end investors. This should be without prejudice to the application of provisions of national law transposing Directives 2014/65/EU and (EU) 2016/97, in particular the obligations on financial market participants and financial advisers as regards product governance, assessments of suitability and appropriateness, and the demands-and-needs test.

(16) Investment decisions and advice might cause, contribute to or be directly linked to effects on sustainability factors that are negative, material or likely to be material.

(17) To ensure the coherent and consistent application of this Regulation, it is necessary to lay down a harmonised definition of 'sustainable investment' which provides that the investee companies follow good governance practices and the precautionary principle of 'do no significant harm' is ensured, so that neither the environmental nor the social objective is significantly harmed.

(18) Where financial market participants, taking due account of their size, the nature and scale of their activities and the types of financial products they make available, consider principal adverse impacts, whether material or likely to be material, of investment decisions on sustainability factors, they should integrate in their processes, including in their due diligence processes, the procedures for considering the principal adverse impacts alongside the relevant financial risks and relevant sustainability risks. The information on such procedures might describe how financial market participants discharge their sustainability-related stewardship responsibilities or other shareholder engagements. Financial market participants should include on their websites information on those procedures and descriptions of the principal adverse impacts. In that respect, the Joint Committee of the European Banking Authority established by Regulation (EU) No 1093/2010 of the European Parliament and of the Council ([15]) (EBA), the European Insurance and Occupational Pensions Authority established by Regulation (EU) No 1094/2010 of the European Parliament and of the Council ([16])

(EIOPA) and the European Securities and Markets Authority established by Regulation (EU) No 1095/2010 of the European Parliament and of the Council ([17]) (ESMA) (the 'Joint Committee'), and financial market participants and financial advisers should consider the due diligence guidance for responsible business conduct developed by the Organisation for Economic Co-operation and Development (OECD) and the United Nations-supported Principles for Responsible Investment.

(19)The consideration of sustainability factors in the investment decision-making and advisory processes can realise benefits beyond financial markets. It can increase the resilience of the real economy and the stability of the financial system. In so doing, it can ultimately impact on the risk-return of financial products. It is therefore essential that financial market participants and financial advisers provide the information necessary to enable end investors to make informed investment decisions.

(20)Financial market participants which consider the principal adverse impacts of investment decisions on sustainability factors should disclose in the pre-contractual information for each financial product, concisely in qualitative or quantitative terms, how such impacts are considered as well as a statement that information on the principal adverse impacts on sustainability factors is available in the ongoing reporting. Principal adverse impacts should be understood as those impacts of investment decisions and advice that result in negative effects on sustainability factors.

(21)Sustainable products with various degrees of ambition have been developed to date. Therefore, for the purposes of pre-contractual disclosures and disclosures in periodical reports, it is necessary to distinguish between the requirements for financial products which promote environmental or social characteristics and those for financial products which have as an objective a positive impact on the environment and society. As a consequence, as regards the financial products with environmental or social characteristics, financial market participants should disclose whether and how the designated index, sustainability index or mainstream index, is aligned with those characteristics and where no benchmark is used, information on how the sustainability characteristics of the financial products are met. As regards financial products which have as an objective a positive impact on the environment and society, financial market participants should disclose which sustainable benchmark they use to measure the sustainable performance and where no benchmark is used, explain how the sustainable objective is met. Those disclosures by means of periodic reports should be carried out annually.

(22)This Regulation is without prejudice to the rules on remuneration or the assessment of the performance of staff of financial market participants and financial advisers under Directives 2009/65/EC, 2009/138/EC, 2011/61/EU, 2013/36/EU, 2014/65/EU, (EU) 2016/97, (EU) 2016/2341, and Regulations (EU) No 345/2013 and (EU) No 346/2013, or to implementing acts and national law governing personal and individual pension products, including but not limited to the relevant applicable proportionality criteria such as size, internal organisation and the nature, scope and complexity of the activities in question. It is, however, appropriate to achieve more transparency, in qualitative or quantitative terms, on the remuneration policies of financial market participants and financial advisers, with respect to their investment or insurance advice, that promote sound and effective risk management with respect to

sustainability risks whereas the structure of remuneration does not encourage excessive risk-taking with respect to sustainability risks and is linked to risk-adjusted performance.

(23)To enhance transparency and inform end investors, access to information on how financial market participants and financial advisers integrate relevant sustainability risks, whether material or likely to be material, in their investment decision making processes, including the organisational, risk management and governance aspects of such processes, and in their advisory processes, respectively, should be regulated by requiring those entities to maintain concise information about those policies on their websites.

(24)The current disclosure requirements set out in Union law do not require the disclosure of all the information necessary to properly inform end investors about the sustainability-related impact of their investments in financial products with environmental or social characteristics or financial products which pursue sustainability objectives. Therefore, it is appropriate to set out more specific and standardised disclosure requirements with regard to such investments. For instance, the overall sustainability-related impact of financial products should be reported regularly by means of indicators relevant for measuring the chosen sustainable investment objective. Where an appropriate index has been designated as a reference benchmark, that information should also be provided for the designated index as well as for a broad market index to allow for comparison. Where EuSEF managers make available information on the positive social impact that is the objective of a given fund, on the overall social outcome achieved and on the related methods used in accordance with Regulation (EU) No 346/2013, they might, where appropriate, use such information for the purposes of the disclosures under this Regulation.

(25)Directive 2013/34/EU of the European Parliament and of the Council ([18]) imposes transparency obligations as regards environmental, social and corporate governance matters in non-financial reporting. However, the form and presentation required by that Directive is not, always suitable for direct use by financial market participants and financial advisers when dealing with end investors. Financial market participants and financial advisers should have the option to use information in management reports and non-financial statements for the purposes of this Regulation in accordance with that Directive, where appropriate.

(26)To ensure the reliability of information published on the websites of financial market participants and financial advisers, such information should be kept up to date, and any revisions or changes to such information should be clearly explained.

(27)Even though this Regulation does not cover national social security schemes covered by Regulations (EC) No 883/2004 and (EC) No 987/2009, in view of the fact that Member States increasingly open up parts of the management of compulsory pension schemes within their social security systems to financial market participants or other entities under private law, and as such schemes are exposed to sustainability risks and might consider adverse sustainability impacts, promote environmental or social characteristics or pursue sustainable investment, Member States should have the option to apply this Regulation with regard to such schemes in order to mitigate information asymmetries.

(28)This Regulation should not prevent a Member State from adopting or maintaining in force more stringent provisions on the publication of climate change adaptation policies and on additional disclosures to end investors regarding sustainability risks provided that the affected

financial market participants and financial advisers, have their head offices in its territory. However, such provisions should not impede the effective application of this Regulation or the achievement of its objectives.

(29)Under Directive (EU) 2016/2341, IORPs are already required to apply governance and risk-management rules to their investment decisions and risk assessments in order to ensure continuity and regularity. Investment decisions and the assessment of relevant risks, including environmental, social and governance risks, should be made in such a manner as to ensure compliance with the interests of members and beneficiaries of IORPs. EIOPA should issue guidelines specifying how investment decisions and risk assessments by IORPs are to take into account environmental, social and governance risks under that Directive.

(30)EBA, EIOPA and ESMA (collectively, the 'ESAs') should be mandated, through the Joint Committee, to develop draft regulatory technical standards to further specify the content, methodologies and presentation of information in relation to sustainability indicators with regard to climate and other environment-related adverse impacts, to social and employee matters, to respect for human rights, and to anti-corruption and anti-bribery matters, as well as to specify the presentation and content of the information with regard to the promotion of environmental or social characteristics and sustainable investment objectives to be disclosed in pre-contractual documents, annual reports and on websites of financial market participants in accordance with Articles 10 to 14 of Regulations (EU) No 1093/2010, (EU) No 1094/2010 and (EU) No 1095/2010. The Commission should be empowered to adopt those regulatory technical standards by means of delegated acts pursuant to Article 290 of the Treaty on the Functioning of the European Union (TFEU) and in accordance with Articles 10 to 14 of Regulations (EU) No 1093/2010, (EU) No 1094/2010 and (EU) No 1095/2010.

(31)The ESAs should be mandated, through the Joint Committee, to develop draft implementing technical standards to determine the standard presentation of information on the promotion of environmental or social characteristics and sustainable investments in marketing communications. The Commission should be empowered to adopt those implementing technical standards by means of an implementing act pursuant to Article 291 TFEU and in accordance with Article 15 of Regulations (EU) No 1093/2010, (EU) No 1094/2010 and (EU) No 1095/2010.

(32)Since annual reports in principle summarise business results for complete calendar years, the provisions of this Regulation regarding the transparency requirements for such reports should not apply until 1 January 2022.

(33)The disclosure rules contained in this Regulation should supplement the provisions of Directives 2009/65/EC, 2009/138/EC, 2011/61/EU, 2014/65/EU, (EU) 2016/97 and (EU) 2016/2341, and Regulations (EU) No 345/2013, (EU) No 346/2013, (EU) 2015/760 and (EU) 2019/1238.

(34)This Regulation respects fundamental rights and observes the principles recognised in particular by the Charter of the Fundamental Rights of the European Union.

(35)Since the objectives of this Regulation, namely to strengthen protection for end investors and improve disclosures to them, including in cases of cross-border purchases by end investors, cannot be sufficiently achieved by the Member States but can rather, by reason of the need to lay down uniform disclosure requirements, be better achieved at Union level, the Union may

adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty on European Union. In accordance with the principle of proportionality, as set out in that Article, this Regulation does not go beyond what is necessary in order to achieve those objectives,

HAVE ADOPTED THIS REGULATION:

Article 1

Subject matter

This Regulation lays down harmonised rules for financial market participants and financial advisers on transparency with regard to the integration of sustainability risks and the consideration of adverse sustainability impacts in their processes and the provision of sustainability-related information with respect to financial products.

Article 2

Definitions

For the purposes of this Regulation, the following definitions apply:

(1) 'financial market participant' means:

(a) an insurance undertaking which makes available an insurance-based investment product (IBIP);

(b) an investment firm which provides portfolio management;

(c) an institution for occupational retirement provision (IORP);

(d) a manufacturer of a pension product;

(e) an alternative investment fund manager (AIFM);

(f) a pan-European personal pension product (PEPP) provider;

(g) a manager of a qualifying venture capital fund registered in accordance with Article 14 of Regulation (EU) No 345/2013;

(h) a manager of a qualifying social entrepreneurship fund registered in accordance with Article 15 of Regulation (EU) No 346/2013;

(i) a management company of an undertaking for collective investment in transferable securities (UCITS management company); or

(j) a credit institution which provides portfolio management;

(2) 'insurance undertaking' means an insurance undertaking authorised in accordance with Article 18 of Directive 2009/138/EC;

(3) 'insurance-based investment product' or 'IBIP' means:

(a) an insurance-based investment product as defined in point (2) of Article 4 of Regulation (EU) No 1286/2014 of the European Parliament and of the Council ([19]); or

(b) an insurance product which is made available to a professional investor and which offers a maturity or surrender value that is wholly or partially exposed, directly or indirectly, to

5. Financial advisers shall publish and maintain on their websites:

(a) information as to whether, taking due account of their size, the nature and scale of their activities and the types of financial products they advise on, they consider in their investment advice or insurance advice the principal adverse impacts on sustainability factors; or

(b) information as to why they do not to consider adverse impacts of investment decisions on sustainability factors in their investment advice or insurance advice, and, where relevant, including information as to whether and when they intend to consider such adverse impacts.

6. By 30 December 2020, the ESAs shall develop, through the Joint Committee, draft regulatory technical standards in accordance with Articles 10 to 14 of Regulations (EU) No 1093/2010, (EU) No 1094/2010 and (EU) No 1095/2010 on the content, methodologies and presentation of information referred to in paragraphs 1 to 5 of this Article in respect of the sustainability indicators in relation to adverse impacts on the climate and other environment-related adverse impacts.

The ESAs shall, where relevant, seek input from the European Environment Agency and the Joint Research Centre of the European Commission.

Power is delegated to the Commission to supplement this Regulation by adopting the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulations (EU) No 1093/2010, (EU) No 1094/2010 and (EU) No 1095/2010.

7. By 30 December 2021, the ESAs shall develop, through the Joint Committee, draft regulatory technical standards in accordance with Articles 10 to 14 of Regulations (EU) No 1093/2010, (EU) No 1094/2010 and (EU) No 1095/2010 on the content, methodologies and presentation of information referred to in paragraphs 1 to 5 of this Article in respect of sustainability indicators in relation to adverse impacts in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.

Power is delegated to the Commission to supplement this Regulation by adopting the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulations (EU) No 1093/2010, (EU) No 1094/2010 and (EU) No 1095/2010.

Article 5

Transparency of remuneration policies in relation to the integration of sustainability risks

1. Financial market participants and financial advisers shall include in their remuneration policies information on how those policies are consistent with the integration of sustainability risks, and shall publish that information on their websites.

2. The information referred to in paragraph 1 shall be included in remuneration policies that financial market participants and financial advisers are required to establish and maintain in accordance with sectoral legislation, in particular Directives 2009/65/EC, 2009/138/EC, 2011/61/EU, 2013/36/EU, 2014/65/EU, (EU) 2016/97 and (EU) 2016/2341.

Article 6

Transparency of the integration of sustainability risks

1. Financial market participants shall include descriptions of the following in pre-contractual disclosures:

(a) the manner in which sustainability risks are integrated into their investment decisions; and

(b) the results of the assessment of the likely impacts of sustainability risks on the returns of the financial products they make available.

Where financial market participants deem sustainability risks not to be relevant, the descriptions referred to in the first subparagraph shall include a clear and concise explanation of the reasons therefor.

2. Financial advisers shall include descriptions of the following in pre-contractual disclosures:

(a) the manner in which sustainability risks are integrated into their investment or insurance advice; and

(b) the result of the assessment of the likely impacts of sustainability risks on the returns of the financial products they advise on.

Where financial advisers deem sustainability risks not to be relevant, the descriptions referred to in the first subparagraph shall include a clear and concise explanation of the reasons therefor.

3. The information referred to in paragraphs 1 and 2 of this Article shall be disclosed in the following manner:

(a) for AIFMs, in the disclosures to investors referred to in Article 23(1) of Directive 2011/61/EU;

(b) for insurance undertakings, in the provision of information referred to in Article 185(2) of Directive 2009/138/EC or, where relevant, in accordance with Article 29(1) of Directive (EU) 2016/97;

(c) for IORPs, in the provision of information referred to in Article 41 of Directive (EU) 2016/2341;

(d) for managers of qualifying venture capital funds, in the provision of information referred to in Article 13(1) of Regulation (EU) No 345/2013;

(e) for managers of qualifying social entrepreneurship funds, in the provision of information referred to in Article 14(1) of Regulation (EU) No 346/2013;

(f) for manufacturers of pension products, in writing in good time before a retail investor is bound by a contract relating to a pension product;

(g) for UCITS management companies, in the prospectus referred to in Article 69 of Directive 2009/65/EC;

(h) for investment firms which provide portfolio management or provide investment advice, in accordance with Article 24(4) of Directive 2014/65/EU;

(i) for credit institutions which provide portfolio management or provide investment advice, in accordance with Article 24(4) of Directive 2014/65/EU;

(j) for insurance intermediaries and insurance undertakings which provide insurance advice with regard to IBIPs and for insurance intermediaries which provide insurance advice with regard to pension products exposed to market fluctuations, in accordance with Article 29(1) of Directive (EU) 2016/97;

(k) for AIFMs of ELTIFs, in the prospectus referred to in Article 23 of Regulation (EU) 2015/760;

(l) for PEPP providers, in the PEPP key information document referred to in Article 26 of Regulation (EU) 2019/1238.

Article 7

Transparency of adverse sustainability impacts at financial product level

1. By 30 December 2022, for each financial product where a financial market participant applies point (a) of Article 4(1) or Article 4(3) or (4), the disclosures referred to in Article 6(3) shall include the following:

(a) a clear and reasoned explanation of whether, and, if so, how a financial product considers principal adverse impacts on sustainability factors;

(b) a statement that information on principal adverse impacts on sustainability factors is available in the information to be disclosed pursuant to Article 11(2).

Where information in Article 11(2) includes quantifications of principal adverse impacts on sustainability factors, that information may rely on the provisions of the regulatory technical standards adopted pursuant to Article 4(6) and (7).

2. Where a financial market participant applies point (b) of Article 4(1), the disclosures referred to in Article 6(3) shall include for each financial product a statement that the financial market participant does not consider the adverse impacts of investment decisions on sustainability factors and the reasons therefor.

Article 8

Transparency of the promotion of environmental or social characteristics in pre-contractual disclosures

1. Where a financial product promotes, among other characteristics, environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices, the information to be disclosed pursuant to Article 6(1) and (3) shall include the following:

(a) information on how those characteristics are met;

(b) if an index has been designated as a reference benchmark, information on whether and how this index is consistent with those characteristics.

2. Financial market participants shall include in the information to be disclosed pursuant to Article 6(1) and (3) an indication of where the methodology used for the calculation of the index referred to in paragraph 1 of this Article is to be found.

3. The ESAs shall, through the Joint Committee, develop draft regulatory technical standards to specify the details of the presentation and content of the information to be disclosed pursuant to this Article.

When developing the draft regulatory technical standards referred to in the first subparagraph, the ESAs shall take into account the various types of financial products, their characteristics and the differences between them, as well as the objective that disclosures are to be accurate, fair, clear, not misleading, simple and concise.

The ESAs shall submit the draft regulatory technical standards referred to in the first subparagraph to the Commission by 30 December 2020.

Power is delegated to the Commission to supplement this Regulation by adopting the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulations (EU) No 1093/2010, (EU) No 1094/2010 and (EU) No 1095/2010.

Article 9

Transparency of sustainable investments in pre-contractual disclosures

1. Where a financial product has sustainable investment as its objective and an index has been designated as a reference benchmark, the information to be disclosed pursuant to Article 6(1) and (3) shall be accompanied by the following:

(a) information on how the designated index is aligned with that objective;

(b) an explanation as to why and how the designated index aligned with that objective differs from a broad market index.

2. Where a financial product has sustainable investment as its objective and no index has been designated as a reference benchmark, the information to be disclosed pursuant to Article 6(1) and (3) shall include an explanation on how that objective is to be attained.

3. Where a financial product has a reduction in carbon emissions as its objective, the information to be disclosed pursuant to Article 6(1) and (3) shall include the objective of low carbon emission exposure in view of achieving the long-term global warming objectives of the Paris Agreement.

By way of derogation from paragraph 2 of this Article, where no EU Climate Transition Benchmark or EU Paris-aligned Benchmark in accordance with Regulation (EU) 2016/1011 of the European Parliament and of the Council ([20]) is available, the information referred to in Article 6 shall include a detailed explanation of how the continued effort of attaining the objective of reducing carbon emissions is ensured in view of achieving the long-term global warming objectives of the Paris Agreement.

4. Financial market participants shall include in the information to be disclosed pursuant to Article 6(1) and (3) an indication of where the methodology used for the calculation of the indices referred to in paragraph 1 of this Article and the benchmarks referred to in the second subparagraph of paragraph 3 of this Article are to be found.

5. The ESAs shall, through the Joint Committee, develop draft regulatory technical standards to specify the details of the presentation and content of the information to be disclosed pursuant to this Article.

When developing the draft regulatory technical standards referred to in the first subparagraph of this paragraph, the ESAs shall take into account the various types of financial products, their objectives as referred to in paragraphs 1, 2 and 3 and the differences between them as well as the objective that disclosures are to be accurate, fair, clear, not misleading, simple and concise.

The ESAs shall submit the draft regulatory technical standards referred to in the first subparagraph to the Commission by 30 December 2020.

Power is delegated to the Commission to supplement this Regulation by adopting the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of

Bibliography

Arrow, K. J. (1985). The economics of agency. *Harvard Business School Press*, 37-51.

Bardi, A., & Schwartz, S. H. (2003). Values and Behavior: Strength and Structure of Relations. *Personality and Social Psychology Bulletin*, 1207–1220.

Bassen, A., Jastram, S., & Meyer, K. (2005). Corporate Social Responsibility: eine Begriffserläuterung. *Zeitschrift für Wirtschafts- und Unternehmensethik*, 231-236.

Baur, N., & Blasius, J. (2014). *Handbuch Methoden der empirischen Sozialforschung.* Wiesbaden: Springer Fachmedien.

Berg, F., Kölbel, J., & Rigobon, R. (2022). *Aggregate Confusion: The Divergence of ESG Ratings.* MIT Sloan, University of Zurich.

Bergius, S. (2014, 07 11). Dominanz herkömmlichen Wirtschaftens und Investierens. *Handelsblatt Business Briefing*, pp. 3-8.

Bloor, M., & Wood, F. (2006). Keywords in qualitative methods: A vocabulary of research concepts. *SAGE journals*.

Brzinzky, J. (2011, 05 05). *Greenwashing: Grünes Mäntelchen für schwarze Schafe.* Retrieved from GEO: https://www.geo.de/natur/nachhaltigkeit/4538-rtkl-greenwashing-greenwashing-gruenes-maentelchen-fuer-schwarze-schafe

Cam, S., Akshat, R., & Saijel, K. (2021, 12 11). *Brave new europe.* Retrieved from MSCI, the largest ESG rating company, doesn't even try to measure the impact of a corporation on the world. It's all about whether the world might mess with the bottom line: https://braveneweurope.com/cam-simpson-akshat-rathi-saijel-kishan-msci-the-largest-esg-rating-company-doesnt-even-try-to-measure-the-impact-of-a-corporation-on-the-world-its-all-about-whether-the-world-m

Cappucci, M. (2018). The ESG Integration Paradox. *Journal of Applied Corporate Finance*, 22-28.

Carroll, A. (1991). The Pyramid of Corporate Social Responsibility: Toward the Moral Management of Organizational Stakeholders. Business Horizons.

Chatterji, A. K., Levine, D. I., & Toffel, M. W. (2009). How Well Do Social Ratings Actually Measure Corporate Social Responsibility? *Journal of Economics & Management Strategy*, 125–169.

Crane, A., & Matten, D. (2010). Business ethics: managing citizenship and sustainability in the age of globalization. *Scientific research an academic publisher*, 64.

Delmas, M. A., Dror, E., & Nairn-Birch, N. (2013). Triangulating Environmental Performance: What do Corporate Social Responsibility Rating really capture? *Academy of Management Perspectives*, 255-267.

Dembinski, P., Bonvin, J.-M., Domen, E., & Monnet, F.-M. (2003). The Ethical Foundations of Responsible Investment. *Journal of Business Ethics*, 203-213.

Dodge v. Ford Motor Co., 204 Mich. 459, 170N.W 668 (1919):1–23 (Supreme Court of Michigan 02 07, 1919).

Döring, N., & Bortz, J. (2006). *Forschungsmethoden und Evaluation: In den Sozial- und Humanwissenschaften.* Berlin: Springer-Verlag.

Durand, P. (2022, 11 14). *European Parliament*. Retrieved from New sustainability reporting rules should hold companies accountable, says Parliament: https://www.europarl.europa.eu/news/en/headlines/economy/20221110STO53001/new-sustainability-reporting-rules-should-hold-firms-accountable-say-meps#:~:text=%E2%80%9CEurope%20is%20showing%20the%20world,lead%20MEP%20for%20this%20issue.

Eccles, R. G., Ioannou, I., & Serafeim, G. (2014). The Impact of Corporate Sustainability on Organizational Processes and Performance. *Management Science*, 2835–2857.

Elo, S., & Kyngäs, H. (2008). The qualitative content analysis process.

ESMA, T. E. (2022, 06 27). *ESMA PUBLISHES RESULTS OF ITS CALL FOR EVIDENCE ON ESG RATINGS*. Retrieved 10 23, 2022, from https://www.esma.europa.eu/press-news/esma-news/esma-publishes-results-its-call-evidence-esg-ratings

EUR-Lex: EU law. (2019, 11 27). Retrieved from Document 32019R2088: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32019R2088

European Commission. (2022). *Paris Agreement*. Retrieved 11 05, 2022, from https://climate.ec.europa.eu/eu-action/international-action-climate-change/climate-negotiations/paris-agreement_en

European Parliament. (2021, 04 21). *MEPs reach deal with Council on obligation for EU to be climate neutral by 2050*. Retrieved 09 22, 2022, from https://www.europarl.europa.eu/news/en/press-room/20210419IPR02302/meps-reach-deal-with-council-on-obligation-for-eu-to-be-climate-neutral-by-2050

Eurosif. (2008). *European SRI Study*. Retrieved from Eurosif: http://www.eurosif.org/publication/wppa_open/european-sri-study-2008

Eurosif. (2012). *European SRI Study.* Retrieved from Eurosif: http://www.eurosif.org/publication/view/european-sri-study-2012/

Fink, L. (2021). *Larry Fink's 2022 Letter to CEOs*. Retrieved 10 02, 2022, from https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter

Fink, L. (2021). *The Power of Capitalism.* Retrieved from BlackRock: https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter

Friedman, M. (1970, 09 13). The Social Responsibility of Business Is to Increase Its Profits. *The New York Times*, p. 17.

Gelbrich, K. (2007). Blueprinting, sequentielle Ereignismethode und Critical Incident Technique. In R. H. Buber, *Qualitative Marktforschung* (pp. 617-633). Gabler.

Global Reporting Initiative. (2022). *About GRI*. Retrieved 11 02, 2022, from https://www.globalreporting.org/about-gri/

Global Sustainable Investment Alliance. (2013). *2012 Global Sustainable Investment Review*. Retrieved from Global Sustainable Investment Alliance: http://www.gsi-alliance.org/resources/

Götz, A. (2021, 10). *ESG: Warum der "E"-Fokus zu einer Fehlallokation von Kapital führt*. Retrieved 10 16, 2022, from https://www.lupusalpha.de/presse/esg-warum-der-e-fokus-zu-einer-fehlallokation-von-kapital-fuehrt/

Hart, O., & Zingales, L. (2017). Companies Should Maximize Shareholder Welfare Not Market Value. *Journal of Law*, 245-274.

Hartwill, A., Rontaler, A., & Firth, L. (2021). *ESG beyond E - the rise of stakeholder.* Simmons & Simmons LLP.

Hiß, S., & Nagel, S. (2012). Ratingagenturen zwischen Krise und Regulierung. In *Handbuch der Wirtschaftssoziologie* (pp. 331-348). Baden-Baden: Springer Link.

Holloway, I., & Todres, L. (2016). The Status of Method: Flexibility, Consistency and Coherence. *SAGE journals*.

Homburg, C. (2020). *Grundlagen des Marketingmanagements.* Wiesbaden: Springer Fachmedien.

Hvidkjær, S. (2017). *ESG investing: a literature review.* DANSIF.

IFRS. (2022). *About the International Sustainability Standards Board*. Retrieved 11 02, 2022, from https://www.ifrs.org/groups/international-sustainability-standards-board/

Jäckle, J., & Ackermann, U. (2007). Ratingverfahren aus Emittentensicht. In H. E. Büschgen, & O. Everling, *Handbuch Rating* (pp. 385-404). Wiesbaden: Gabler Verlag.

Kaya, M. (2009). Verfahren der Datenerhebung. In S. K. Albers, *Methodik der empirischen Forschung* (pp. 49-64). Wiesbaden: Gabler Verlag.

Leaper, C., & Ayres, M. (2007). A meta-analytic review of gender variations in adults' language use: Talkativeness, affiliative speech, and assertive speech. *Personality and Social Psychology Review*, pp. 328–363.

Mayring, P. (1994). Qualitative content analysis. In A. Boehm, A. Mengel, & T. Muhr, *Texte verstehen : Konzepte, Methoden, Werkzeuge* (pp. 159-175). Konstanz: UVK Univ.-Verl. Konstanz.

Mayring, P. (2000). Qualitative Content Analysis. *FORUM: QUALITATIVE SOCIAL RESEARCH*.

Morningstar. (2020). *ESG_Fund_Performance_2020. How Does European Sustainable Funds' Perfor-mance Measure Up?*

Novethic. (2018). *NonFinancial Ratings focus on SDGs.* study.

Pope, C. (2006). *Qualitative Research in Health Care.* Blackwell Publishing.

Porco, B. (2021). *Last Place Finish Of Systemic Risk Management Reporting In ESG Survey Raises Red Flags.* Retrieved from Forbes: https://www.forbes.com/sites/edwardsegal/2021/11/16/last-place-finish-of-systemic-risk-management-reporting-in-esg-survey-raises-red-flags/

Powers, B. A., & Knapp, T. R. (2006). *Dictionary of Nursing Theory and Research.* New York: Springer Publishing Company.

PRI, & PWC. (2017). *The SDG Investment Case.* PRI - Principles for Responsible Investment.

Purvis, B. M. (2019). *Three pillars of sustainability: in search of conceptual origins.*

Ransome, W., & Sampford, C. (2010). *Ethics and Socially Responsible Investment - A Philosophical Approach.* Surrey: Ashgate Publishing.

Riccolo, A. (2021). The Lack of Regulation in Preventing Greenwashing of Cosmetics in the U.S. *Journal of Legislation*.

Romero, S., Jeffers, A. E., Beixin, L., Aquilino, F., & DeGaetano, L. (2018). Using ESG Ratings to Build a Sustainability Investing Strategy. *The CPA Journal*.

Sadowski, M., Whitaker, K., & Buckingham, F. (2010). *Rate the Raters Phase One.* SustainAbility.

Scalet, S., & Kelly, T. F. (2010). CSR Rating Agencies: What is Their Global Impact? *Journal of Business Ethics*, 69-88.

Schaltegger, S. (2011). Von CSR zu Corporate Sustainability. In B. Sandberg, *Corporate Social Responsiblity in kommunalen Unternehmen* (pp. 187-199). VS Verlag.

Schaltegger, S. (2012). Sustainability Reporting Beyond Rhetoric: Linking Strategy, Accounting and Communication. In S. Jones, & J. Ratnatunga, *Contemporary issues in sustainability accounting, assurance and reporting* (pp. 183-193). Emerald.

Schneider, A., & Meins, E. (2012). Two Dimensions of Corporate Sustainability Assessment: Towards a Comprehensive Framework. *Business Strategy and the Environment*, 211-222.

Schueth, S. (2003). Socially Responsible Investing in the United States. *Journal of Business Ethics*.

Scott, S. (2007). Corporate Social Responsibility and the Fetter of Profitability. *Social Responsibility Journal*.

Serafeim, P., Kotsantonis, S., Saltzman, D., & Ward, B. (2017). *The Value of Corporate Purpose: A Guide for CEOs and Entrepreneurs.* KKS Advisors.

Sharfman, M. (1996). The construct validity of the Kinder, Lydenberg & Domini social performance ratings data. *Journal of Business Ethics*, 287–296.

Sparkes, R., & Cowton, C. J. (2004). The Maturing of Socially Responsible Investment: A Review of the Developing Link with Corporate Social Responsibility. *Journal of Business Ethics*, pages45–57.

Starica, C. (2008). *Measuring Intangibles: RobecoSAM's Corporate Sustainability Assessment Methodology.* Retrieved from RobecoSAM: http://www.robecosam.com/images/CSA_methodology_en.pdf

Statista. (2020). *Largest asset managers globally by AuM 2019*. Retrieved 09 18, 2022, from https://www.statista.com/statistics/431790/leading-asset-management-companies-worldwide-by-assets/

Staub-Bisang, M. (2011). Nachhaltige Anlagen für institutionelle Investoren. *Neue Zürcher Zeitung*.

Stein, C. H., & Mankowski, E. S. (2004). Asking, Witnessing, Interpreting, Knowing: Conducting Qualitative Research in Community Psychology. *American Journal of Community Psychology*, 125-126.

SustainAbility, G. &. (2014, 01 29). *The 2013 Ratings Survey: Polling the Experts*. Retrieved from SustainAbility: http://www.sustainability.com/library/the-2013-ratings-survey-polling-the-experts#.VD6uj8V_uQM

Teske, S., Nagrath, K., Niklas, S., Talwar, S., Atherton, A., Guerrero Orbe, J., . . . Giurco, D. (2022). Scopes 1, 2, and 3 Industry Emissions and Future Pathways. In *Achieving the Paris Climate Agreement Goals* (pp. 315–336). Springer.

Tuzzolino, F., & Armandi, B. R. (1981). A Need-Hierarchy Framework for Assessing Corporate Social Responsibility. *The Academy of Management Review*, 21.

UN Climate Change Conference. (2021). COP26 Presidency Outcomes The Climate Pact. *COP26 The Glasgow Climate Pact* (pp. 2-27). Glasgow: United Nations; UK Government.

United Nations Climate Change. (2022). *About the Secretariat*. Retrieved 09 22, 2022, from https://unfccc.int/about-us/about-the-secretariat

United Nations Climate Change. (2022). *What is the Kyoto Protocol?* Retrieved 09 22, 2022, from https://unfccc.int/kyoto_protocol

United Nations Global Compact, GRI. (2018). *INTEGRATING THE SDGs INTO CORPORATE REPORTING.* A practical guide.

Viviers, S., & Eccles, N. (2012). 35 years of socially responsible investing (SRI) research - General trends over time. *South African Journal of Business Managmenet*, 1-16.

WCED, W. C. (1987). *Our common future.*

Windolph, S. E. (2011). Assessing Corporate Sustainability Through Ratings: Challenges and Their Causes. *Journal of Environmental Sustainability*, 38-42.

Windolph, S. E. (2013, 10 30). Motivations for Corporate Sustainability Management: Contrasting Survey Results and Implementation. *Journal of Environmental Sustainability*, pp. 37-57.

Wong, C., & Petroy, E. (2020). *Rate the Raters 2020.* SustainAbility an ERM Group company.