History of ESG Metrics – how we got to where we are

Moderator: Todd Bridges, ESG Research and Development, State Street Global Advisors

Judith Stroehle, Oxford University, began by discussing the evolution of ESG metrics, including their growing demand and supply. Considering how organizations offering ESG metrics were formed and consolidated, some have screened more holistically while others more specifically, some have offered data for investors while others have offered data for larger companies and universities, some have been values-driven while others value-driven, and some have defined materiality differently than others. For example, GRI defines materiality as externality, whereas SASB defines materiality based on returns. She added that more and more organizations are using AI and Machine Learning to create more data and offerings in the ESG space. Her paper focuses on the history of KLD Research and Analytics and Innovest, which merged to create MSCI.

KLD Research and Analytics was founded in 1988 with a mission to remove barriers to socially responsible investing. It had a five point scale for major strengths and weakness, with no aggregate score. Using consistent metrics across industries and absolute assessments, it captured the players with large footprints. It defined materiality through impact on the wider society, making it a values-driven data vendor.

Innovest was founded in 1995 in New York and Toronto as an environmental investment research advisory firm. It employed a much more quantitative approach, considering materiality weighted by cap and benchmarked to your peers, making it a value-driven data vendor.

When Innovest and KLD merged to form MSCI, the Innovest methodology prevailed, despite MSCI’s efforts to keep the best aspects of both methodologies. There was market demand for quantifiable data, as well as demand for scalability and financial materiality. KLD had no aggregate score, so the interpretation of its data varied by field. Judith highlighted the importance of data contextualization and understanding the underlying assumptions of data when speaking about ESG. Social construction and making sense of data takes place both at the level of data supply (data creators) and data demand (data users).

Todd Cort, YISF, discussed the paper he co-wrote with Dan Esty, which focuses on a strawman for the structuring space. There are three types of standards: methodological standards, indicator/materiality-based standards, and impact metrics. He argued that the materiality standard should have commonality across companies, going further than SASB. There is opportunity for the governments to be brought into the space and push for one common standard rather than assessing with varying company standards.

Arianne de Vienne, ISS-oekom, discussed that as ESG has been increasingly adopted, the investment community is pushing for increasingly standardized methodology for reporting and quantification of ESG. They argue that while standardization is useful for setting a minimum requirement, it is too rigid an approach to assess materiality on the ESG side. The ISS-o
method has specific sector metrics to address the different types of risks that each sector faces. It is important to assess specific business models to adequately consider individual company materiality. She gives the example of the software industry to show how different companies, such as business to business, business to consumer, and hardware companies, all take different weighting of material issues. The ISS-o method is also very forward-looking.

**Q and A:** Todd’s questions to the panel focused on ESG standardization, materiality, legislation, and disclosure. Judith argued that we only need standards for corporate disclosure of non-financial risks, but not ESG metrics. Dan Esty argued that we have market failure, because confusion on ESG metrics has held back sustainable finance. There needs to be a core set of metrics companies are required to provide on a consistent basis across countries. Dan also critiqued GRI for being too broad, but SASB for going too far in the other direction and missing governance and social metrics. Dan thinks we need some common standard, some industry specific (SASB) and some company specific (ISS-o). The panel commented on the government’s definition of materiality being largely based on financial notions today because of the role of the SEC, but that it is moving to a broader definition based on both social and financial notions. The panel also noted that the EU has moved the conversation on ESG metrics forward and created benchmarks, whereas increasing demand from asset managers in the US based on things that are not yet law but are de facto law are moving it forward here. Todd Cort commented on pressure from private equity, big data, and stock exchanges on small cap companies to disclose ESG metrics.