

BUYER BEWARE: VARIATION AND OPACITY IN ESG AND ESG INDEX FUNDS

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Evidence of the tremendous rise in the significance of environmental, social, and governance (ESG) investing is coming from all quarters. Fund flows into ESG investment vehicles are growing at a sustained and sometimes exponential pace. Fund complexes are rushing to design products, creating and rebranding scores of mutual funds and exchange traded funds (ETFs), including lower-cost indexed options. Industry leaders, critics, and commentators are all heralding the sea change as a shift in investing—and corporate governance—to more broadly consider environmental and social factors.

This Article provides vital context for this conversation. Its descriptive account of the ESG investment landscape drawn from hand-collected 2018–2019 data on a sample of active and passive ESG and traditional funds documents great variation in their investment strategies, portfolios, voting records, and fees. The underlying variation across funds, however, is largely opaque to consumers—who rely on the ESG acronym at their peril. Building on our case study, we examine the supply and demand side drivers fueling ESG market growth, variation, and opacity, and explore

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mechanisms to better match high-ESG committed investors to high-ESG committed funds, including enhanced transparency and regulation of intermediaries.

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INTRODUCTION

Environmental, social, and governance (ESG) investing—investment strategies that incorporate the environmental, social, and governance practices of investee firms in portfolio composition and management—grew by leaps and bounds in the last decade. At the start

of 2020, the market offered investors roughly 300 ESG funds¹—a subset of the more broadly defined sustainable funds.² This number represents huge growth (considering there were ninety “sustainable” funds in 2014).³ Fund growth in this area outpaces growth in traditional mutual fund and exchange traded fund (ETF) markets. ESG funds manage increasingly large pools of capital. After several years of growth, in 2018 ESG funds gained \$5.5 billion assets under management (AUM).⁴ In 2019, ESG inflows shattered prior records reaching over \$20 billion⁵—growth in large part attributable to re-branding of existing funds into ESG products.⁶

¹ John Hale, *Sustainable Fund Flows in 2019 Smash Previous Records*, MORNINGSTAR (Jan. 10, 2020), <https://www.morningstar.com/articles/961765/sustainable-fund-flows-in-2019-smash-previous-records> [<https://perma.cc/PS7X-F37X>]; see also MORNINGSTAR, SUSTAINABLE FUNDS U.S. LANDSCAPE REPORT 1 (2020) [hereinafter MORNINGSTAR 2020] (“After having steadily gained prominence over the past decade, sustainable investing appears to be reaching a tipping point. For evidence, one need look no further than the nearly fourfold increase in assets that flowed into sustainable funds in the United States in 2019.”).

² “While the definition of sustainable investing continues to evolve, this refers to a range of overarching investing approaches or strategies that encompass values-based investing, negative screening (exclusions), thematic and impact investing, ESG integration, company engagement and proxy voting. These are not mutually exclusive.” *A Decade of Sustainable Funds Investing: 10 Years/10 Charts*, SUSTAINABLE INVESTING, <https://www.sustainableinvest.com/sustainable-investing-decade> [<https://perma.cc/24BX-9U6C>].

³ See MORNINGSTAR, SUSTAINABLE FUNDS U.S. LANDSCAPE REPORT 3, 6 (2018), https://cdn.ymaws.com/dciia.org/resource/collection/8606CD14-06A5-4277-9507-C397C1C8DEA0/Sustainable_Funds_Landscape_013018.pdf [<https://perma.cc/4Z5V-ATGU>].

⁴ MORNINGSTAR 2020, *supra* note 1, at 14 (noting a \$5.5 billion in net flows in 2018 to sustainable funds); see also MORNINGSTAR, SUSTAINABLE FUNDS U.S. LANDSCAPE REPORT 11–12 (2018), https://cdn.ymaws.com/dciia.org/resource/collection/8606CD14-06A5-4277-9507-C397C1C8DEA0/Sustainable_Funds_Landscape_013018.pdf [<https://perma.cc/4Z5V-ATGU>]. “Investor interest in ESG funds, alongside market appreciation, drove a 37% annual increase in assets to \$445 billion in 2017.” *Sustainable Investing Grows on Pensions, Millennials*, BLOOMBERG (Apr. 4, 2018), <https://www.bloomberg.com/professional/blog/sustainable-investing-grows-pensions-millennials> [<https://perma.cc/LDW5-75AK>].

⁵ MORNINGSTAR 2020, *supra* note 1 (reporting “flows into sustainable funds totaled \$21.4 billion in 2019”).

⁶ See *A Decade of Sustainable Funds Investing: 10 Years/10 Charts*, *supra* note 2; MORNINGSTAR 2020, *supra* note 1 (“In 2019, 30 new funds launched (plus one in late December 2018 that did not make it into last year’s report) and 11 existing conventional funds were repurposed as sustainable funds.”).

ESG markets, like the U.S. fund market more generally, frequently incorporate passive strategies.⁷ Passively managed funds compose about a third of the sustainable funds market.⁸ No longer a niche or specialty area, ESG investing today is massive. Global ESG assets under management reached \$30 trillion in 2019.⁹

This transformation can be seen not only in ballooning fund options and AUM but also in the dramatic shift in the conversation around the contours of investing and corporate governance. Investment industry leaders like State Street and BlackRock are issuing commitments to use ESG factors to build and manage investment portfolios.¹⁰ Those leading

⁷ Passive management refers to the practice of building a fund portfolio to match an external index or set of rules for firm inclusion and retention, such as funds with portfolios constructed to match the S&P 500 or Russell 3000 indexes of companies. See Jan Fichtner et al., *Hidden Power of the Big Three? Passive Index Funds, Re-Concentration of Corporate Ownership, and New Financial Risk*, 19 BUS. & POL. 298, 298–99 (2017). Passive contrasts with active management, under which fund managers select investments for inclusion and retention in a fund portfolio based on their own research and predictions about the investment's quality and fitness for a fund. See *id.* at 299. As passive strategies require far less research and ongoing assessment, they are associated with lower fees. See *id.* at 302. Passive investment strategies are rising in popularity in large part because, net of fees, on aggregate they tend to match or outperform active alternatives. See *id.* For statistics on the size and growth of passive investing, see generally *id.* and see also *infra* notes 48–52.

⁸ See MORNINGSTAR 2020, *supra* note 1 (reporting 2019 numbers); Reshma Kapadia, *Sustainable Funds' Big Divide: Active vs. Passive Investing*, BARRON'S (Feb. 7, 2020, 2:35 PM), <https://www.barrons.com/articles/sustainable-funds-big-divide-active-vs-passive-investing-51581104128> [<https://perma.cc/HFS5-6LFN>].

⁹ Pippa Stevens, *Your Complete Guide to Investing with a Conscience, a \$30 Trillion Market Just Getting Started*, CNBC (Dec. 14, 2019, 8:15 AM), <https://www.cnbc.com/2019/12/14/your-complete-guide-to-socially-responsible-investing.html> [<https://perma.cc/4HZC-FLJ5>]; see *Sustainable Investing Grows on Pensions, Millennials*, *supra* note 4 (noting that global estimates include investments “labeled as sustainable, responsible or ethical investing” and amounted to \$23 trillion in prior years and citing to estimates provided by the Global Sustainable Investment Alliance).

¹⁰ See, e.g., Letter from Cyrus Taraporevala, President & Chief Exec. Officer, State St. Glob. Advisors, to Board Members, State St. Glob. Advisors (Jan. 28, 2020), <https://www.ssga.com/library-content/pdfs/insights/CEOs-letter-on-SSGA-2020-proxy-voting-agenda.pdf> [<https://perma.cc/F3XE-TSDT>] (announcing State Street's plan “to use our proxy voting power to ensure companies are identifying material ESG issues and incorporating the implications into their long-term strategy”); Letter from Larry Fink, Chairman & Chief Exec. Officer, BlackRock, to Chief Executive Officers, A Fundamental Reshaping of Finance (Jan. 2020), <https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter> [<https://perma.cc/C7TG-39BJ>]; see also Robert G. Eccles & Svetlana Klimenko, *The Investor Revolution*, HARV. BUS. REV., May–June 2019, at 106 (reporting broad agreement among top executives across global investment companies and asset owners that ESG issues are an important component in evaluating

some of the largest portfolio companies have likewise signaled a shift to support stakeholder—rather than shareholder only—focused governance.¹¹ The Big Four accounting firms and corporate members of World Economic Forum pledged to develop metrics for corporate reporting on ESG issues.¹² While there are those who challenge the ascendance of stakeholderism and ESG,¹³ many prominent commentators are broadcasting strong support for the shift as key to long-term investing.¹⁴

In this brave new world where investment and corporate titans tout ESG strategies, investors appear able to secure an enticing combination of traditional investment objectives and far more ambitious ones. In addition to savings or wealth building, ESG products are intended to combat the risks posed by poor governance practices that threaten the stability of capital markets and the economy writ large. They are also intended to counter the existential threats posed by social inequality and climate change. But the substance of environmental, social, and governance considerations in ESG investing is essentially unregulated. Merely flagging the use of ESG factors satisfies securities regulation disclosure mandates but does little to illuminate for investors how a

long-term investments); *supra* notes 225–233 and accompanying text (discussing BlackRock’s evolution on this issue over the past few years).

¹¹ See *Our Commitment*, BUS. ROUNDTABLE, <https://opportunity.businessroundtable.org/ourcommitment> [perma.cc/Y7QD-F33X] (“[M]odernizing its principles on the role of the corporation” to clarify that “[e]ach of our stakeholders is essential[] . . . [and] commit[ting] to deliver[ing] value to all of them, for the future success of our companies, our communities and our country”).

¹² See Press Release, World Econ. F., Measuring Stakeholder Capitalism: World’s Largest Cos. Support Developing Core Set of Universal ESG Disclosures (Jan. 22, 2020), <https://www.weforum.org/press/2020/01/measuring-stakeholder-capitalism-world-s-largest-companies-support-developing-core-set-of-universal-esg-disclosures> [https://perma.cc/29A4-J8T2].

¹³ See Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, CORNELL L. REV. (Dec. 2020) (arguing the shift to stakeholderism will decrease both board accountability and pressure for regulatory reforms necessary to better protect stakeholders).

¹⁴ See, e.g., Martin Lipton et al., *Thoughts for Boards of Directors in 2020*, HARV. L. SCH. F. CORP. GOVERNANCE (Dec. 10, 2019), <https://corpgov.law.harvard.edu/2019/12/10/thoughts-for-boards-of-directors-in-2020> [https://perma.cc/3QGQ-T3UW] (arguing corporate leaders should be “focusing not just on profits, but also on the corporation’s broader purpose and role in the economic and societal ecosystem in order to build a sustainable and long-term value proposition”); Editorial Bd., *Investors Should Look Beyond the Bottom Line*, FIN. TIMES (Oct. 21, 2019), <https://www.ft.com/content/30b3b8d2-f014-11e9-ad1e-4367d8281195>.

particular investment product will use these factors or how to assess whether it has done so effectively. In non-ESG investing, profit, income, and growth have consistent meanings across products, so their disclosure alone allows investors to make useful comparisons between them. In contrast, what qualifies as ESG performance is unclear and contested. Mere disclosure that a fund practices ESG investing will do little to unpack these terms for investors.

To unpack ESG in practice, we conduct a case study of ESG investment practices among “top” funds in 2018–2019 and compare it against non-ESG products in the same fund family. In doing so, we observe two contrasts: ESG versus non-ESG investments and the variation between ESG funds. In our review, we find that ESG transactions are not standardized. There is, in fact, great variation in ESG strategies, holdings, voting practices, and fees. Further, on the matter of holdings and voting, not all ESG funds are distinguishable from non-ESG funds. The ESG implementation continuum is not facially evident to investing consumers and it is hard to unearth. As two experienced researchers, we poured over filings and third-party sites to observe glimpses of ESG in practice. With our case study, we first confirm non-standardization within the ESG market and then provide a descriptive account of the ESG market drivers and the consequences of opaque ESG. We conclude that investors generally get the ESG that they pay for, meaning that high-fee, niche funds have more ESG differentiated holdings and voting patterns. High fees alone, however, do not signal a good ESG return per se. High fees and niche products alone, simply provide an ordering mechanism within our sample. Confusion around ESG implementation creates barriers to high-ESG-committed investors willing to pay so that their capital can support greater ESG impact firms, not just Disney, Amazon, and JP Morgan as many generalist funds do.

Existing securities laws provide no remedy. Other possible sources of regulation to define and regularize the ESG concept likewise provide little insight to investors. The Department of Labor (DOL) can function as a kind of shadow securities regulator through its oversight of ERISA-governed plans.¹⁵ Its limited guidance on ESG investing, though, is a fairly foreboding warning—ERISA fiduciaries may engage in ESG

¹⁵ See Anita K. Krug, *The Other Securities Regulator: A Case Study in Regulatory Damage*, 92 TUL. L. REV. 339, 350–56 (2017) (describing the DOL’s overlapping jurisdiction with the SEC in an article criticizing the former’s 2016 rule designating securities brokers as fiduciaries under ERISA).

investing (whatever that may be) but they are reminded that they cannot do so in any way that would sacrifice returns for beneficiaries. This cautionary instruction does nothing to help delineate the ESG marketplace for investors or product creators. ESG investing has evolved in a relative legal vacuum.

The rise of passive ESG investing adds another dimension to the puzzle. When funds double down on enticing promises of low-fee, guilt-free retirement, how can investors separate fact from fiction? Further, passive ESG necessarily relies on the proliferation of ESG indices and other metrics against which these funds construct their portfolios. An ESG index fund cannot be launched without an ESG index to track. The content of ESG indices could be subjected to regulation, which would indirectly regulate ESG investment products. But while indices have become hugely influential in the market, they are currently developed as proprietary systems by private companies and exist entirely outside the reach of the U.S. financial regulatory architecture.¹⁶ Passive products thus further obscure ESG implementation. To consider these consequences as well, we include a passive ESG sample in our study, creating a comparison between passive and active ESG, as well as with non-ESG funds.

In all comparisons, we conclude that the ESG label acts more as a product signal and branding mechanism than it does a promise of a specific investment strategy or avoided externalities. After concluding that the ESG market signal alone is not enough to match high-ESG commitment investors to high ESG funds—an idea consistent with current literature accounts in law and finance,¹⁷ we explore regulatory

¹⁶ See *Fast Answers: Market Indices*, SEC, <https://www.sec.gov/fast-answers/answersindiceshtm.html> [<https://perma.cc/RA63-3YAR>] (stating “[t]he SEC does not regulate the content of these indices and is not endorsing those described here”).

¹⁷ Paul Brest, Ronald J. Gilson, and Mark A. Wolfson introduce a taxonomy of socially-motivated investors (neutral, values aligned, and value creation) to address their concerns that funds use imprecise and misleading terminology to describe social investments with the implied consequence of misdirecting socially-motivated capital. Paul Brest et al., *How Investors Can (and Can't) Create Social Value* (Eur. Corp. Governance Inst., Working Paper No. 394/2018, 2018). Brad M. Barber, Adair Morse, and Ayako Yasuda, in their paper *Impact Investing*, document investors' willingness to pay for social/environmental returns in the form of reduced financial returns and also note a range of “willingness-to-pay” among heterogeneous investors. Brad Barber et al., *Impact Investing* (Dec. 12, 2019) (unpublished manuscript), <https://ssrn.com/abstract=2705556> [<https://perma.cc/NQ7Z-6F6P>]. A third impact investing article also discusses the range of investor and fund commitment to social benefit returns and the difficulty of matching highly-committed

and market solutions. Our work contributes to existing scholarship on ESG investing¹⁸ and builds upon prior scholarly debates over corporate purpose,¹⁹ corporate social (and environmental) responsibility,²⁰ and sustainable investing.²¹

Part I details how ESG investing has been operationalized, focusing closely on the new trend of passive ESG and the special challenges it raises. A key contribution of this Part is its compilation of data drawn

investors to highly-committed funds, a problem partially addressed in private markets through contracts. Christopher Geczy et al., *Contracts with (Social) Benefits: The Implementation of Impact Investing* 23 (July 1, 2019) (unpublished manuscript), <https://www.ssrn.com/abstract=3159731> [<https://perma.cc/LE56-RA7W>].

¹⁸ See e.g., Virginia Harper Ho, *Risk-Related Activism: The Business Case for Monitoring Nonfinancial Risk*, 41 J. CORP. L. 647 (2016) (advocating for the realignment of long-term firm value, ESG, and regulatory goals); Susan N. Gary, *Values and Value: University Endowments, Fiduciary Duties, and ESG Investing*, 42 J.C. & U.L. 247 (2016) (investigating alignment of fiduciary duties and ESG investing); Florian Berg et al., *Aggregate Confusion: The Divergence of ESG Ratings* (MIT Sloan Sch. Working Paper No. 5822-19, 2019) (documenting divergence of ESG rating scores and the variation of constituent metrics). For a literature review of ESG and related scholarship, see Deborah Burand & Anne Tucker, *Legal Literature Review of Social Entrepreneurship and Impact Investing (2007-2017): Doing Good by Doing Business*, 11 WM. & MARY BUS. L. REV. 1 (2019).

¹⁹ See, e.g., Malcolm S. Salter, *Rehabilitating Corporate Purpose* (Harv. Bus. Sch., Working Paper No. 19-104, 2019) (arguing for a definition of corporate purpose that is “established moral and economic principles that challenge those underlying the shareholder value maximization doctrine”); Afra Afsharipour, *Redefining Corporate Purpose: An International Perspective*, 40 SEATTLE U. L. REV. 465 (2017) (analyzing the Indian Companies Act, drawing comparisons, and identifying lessons for corporate law); LYNN STOUT, *THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC* (2012) (questioning shareholder value as the predominant measure of corporate purpose and proposing alternatives).

²⁰ See, e.g., Shlomit Azgad-Tromer, *The Virtuous Corporation: On Corporate Social Motivation and the Law*, 19 U. PA. J. BUS. L. 341 (2017) (creating a taxonomy for corporate social motivations); Jacob Park & Sonia Kowal, *Socially Responsible Investing 3.0: Understanding Finance and Environmental, Social, and Governance Issues in Emerging Markets*, 18 GEO. PUB. POL’Y REV. 17 (2013) (declaring a “third stage of socially responsible investing” where SRI is a “market reality” in emerging economies); Jayne W. Barnard, *Corporate Boards and New Environmentalism*, 31 WM. & MARY ENVTL. L. & POL’Y REV. 291 (2007) (noting the increasing business case for corporate managers to care about environmental impact and risks).

²¹ See, e.g., Daniel C. Esty & Quentin Karpilow, *Harnessing Investor Interest in Sustainability: The Next Frontier in Environmental Information Regulation*, 36 YALE J. ON REG. 625 (2019) (advocating for mandatory corporate ESG disclosure to facilitate realignment of capital markets with sustainability principles); Meir Statman, *ESG as Waving Banners and as Pulling Plows*, 46 J. PORTFOLIO MGMT. ETHICAL INVESTING 16 (2020) (creating a behavioral finance taxonomy of ESG investors and expectations); Judd F. Sneirson, *Green Is Good: Sustainability, Profitability, and a New Paradigm for Corporate Governance*, 94 IOWA L. REV. 987 (2009) (harmonizing sustainability goals and corporate governance).

from a study of the operations of thirty-one actively- and passively-managed ESG funds and seven non-ESG comparators, pulling data from 2018–2019. In an attempt to discern whether ESG funds are doing something consistent—and consistently different from non-ESG funds—and whether their actions likely align with investor expectations, we hand-collect the investment strategy disclosures, fees, portfolio holdings, shareholder proposal voting records, and tracking errors for each of these funds. Our results confirm that the ESG label alone conveys little information to investors; fund operations vary widely among ESG funds and often overlap with those of non-ESG funds.

As legal regulation only weakly confines ESG investment activity, the next two Parts turn to the force that is driving its growth and implementation: the market. Part II focuses on the role of demand in the growth of the field. Recognizing that ESG investors with different goals (and subject to different regulatory regimes) will have varying appetites for ESG products, this Part maps the contours of the contributions of individual and various types of institutional investors to ESG demand. Part III then turns to the supply side, the role of which has thus far gone largely unexplored and underappreciated. We identify the considerable incentives that investment product creators—fund complexes and index providers in particular—have to expand their ESG investing footprints. The collective takeaway of these Parts exposes serious gaps between reality and the reasonable expectations of investors and society about the capacity of ESG investing to solve social problems. Those gaps are barriers to matching high ESG-committed investors to high ESG funds.

Part IV returns to the question of regulation. It first considers how market forces may shift to incentivize greater accountability and consistency in ESG investment products. Then it sketches the potential legal paths securities regulation, ERISA law, and regulation of index providers might follow to narrow the gap between ESG investor expectations and reality to facilitate better matching. It also offers recommendations for future research.

I. ESG INVESTING EXPLORED

A. *Introduction to ESG Investing*

ESG investing has longstanding roots, spanning examples as diverse as the limitations placed on investment under Sharia law, John Wesley's instructions for his followers to avoid stocks that conflicted with Methodist religious teachings, and the environmental and South African divestment movements.²² Early iterations of socially-inflected mutual fund offerings often screened out "sin" stocks, such as equity in companies that produced alcohol, armaments, or tobacco.²³ These exclusionary (or "negative") screen investment products have been available for decades. Until recently, however, they attracted only a niche audience of highly-committed investors, as the business case for such investing was, at best, unclear.

Exclusionary screens' necessary diversification limits raise concerns that using these strategies to incorporate ESG factors in investment will reduce financial returns. Many studies have borne out these concerns.²⁴ Others find negative screening can be deployed without lowering risk-adjusted returns,²⁵ however; and negative screening continues to be an

²² See Lloyd Kurtz, *Socially Responsible Investment and Shareholder Activism*, in THE OXFORD HANDBOOK OF CORPORATE SOCIAL RESPONSIBILITY 249, 249–55 (Andrew Crane et al. eds. 2008).

²³ See Casey C. Clark & Andy Kirkpatrick, *Impact Investing Under the Uniform Prudent Investor Act*, 32 PROB. & PROP. 32, 33 (2018).

²⁴ See, e.g., Pieter Jan Trinks & Bert Scholtens, *The Opportunity Cost of Negative Screening in Socially Responsible Investing*, 140 J. BUS. ETHICS 193 (2017) (testing a wide variety of negative screens and finding they frequently result in underperformance); Samuel A. Mueller, *The Opportunity Cost of Discipleship: Ethical Mutual Funds and Their Returns*, 52 SOC. ANALYSIS 111 (1991) (finding nine out of ten mutual funds negatively screened for compliance with ethical restrictions underperformed the market).

²⁵ See Susan N. Gary, *Best Interests in the Long Term: Fiduciary Duties and ESG Integration*, 90 U. COLO. L. REV. 731, 752 (2019) (pointing to "two metastudies conclud[ing] that funds using negative screens are more likely to show neutral rather than negative or positive performance when compared to non-SRI benchmarks"); ALEXANDER MONK, SCHRODERS, DEMYSTIFYING NEGATIVE SCREENS: THE FULL IMPLICATIONS OF ESG EXCLUSIONS (2017) (explaining that screening methods vary widely and many need not have significant negative impacts on long-term performance, particularly in the actively managed context).

important component of ESG investing today.²⁶ For example, the Vanguard FTSE Social Index excludes “weapons, tobacco, gambling, alcohol, adult entertainment, and nuclear power” companies.²⁷ New funds utilizing negative screens also continue to come online. In the wake of the Parkland school shootings, fund giant BlackRock offered institutional investors the ability to exclude gun stocks from their portfolios and created gun-free ETFs.²⁸

Numerous other strategies have also been developed to incorporate ESG factors in investing, including both active and passive approaches to composing portfolios of high performing ESG companies. Some active funds practice full integration, considering ESG factors as part of the valuation process for every investment decision.²⁹ For example, at the Morgan Stanley Institutional Global Opportunity Fund the “investment process integrates analysis of sustainability with respect to disruptive change, financial strength, environmental and social externalities and

²⁶ See Stuart Kirk, *How ESG Can Have Unintended Consequences*, FIN. TIMES (Sept. 27, 2018), <https://www.ft.com/content/e32bb67e-ebc9-3407-a83b-b2524a688222> [<https://perma.cc/W6EE-PC2Q>] (“Stock screening is by far the most popular way to invest based on ESG principles, accounting for more than three-quarters of responsibly managed assets globally.”)

²⁷ Vanguard FTSE Soc. Index Fund, Summary Prospectus (Form 497K) (Dec. 3, 2018).

²⁸ See Leslie P. Norton, *BlackRock's Larry Fink: The New Conscience of Wall Street?*, FIN. NEWS LONDON (June 26, 2018, 7:47 AM), <https://www.fnlondon.com/articles/blackrocks-larry-fink-the-new-conscience-of-wall-street-20180626> [<https://perma.cc/29B8-S43Q>]. As a major index fund provider, these new funds did not dislodge BlackRock as a large investor in weapons companies, including the manufacturer of the gun used at Parkland. Negative screens are incompatible with a pure index strategy, though BlackRock and other index fund providers have pledged to engage with gun manufacturers on issues raised by mass shootings. See, e.g., Matt Levine, *BlackRock Ends up in an Awkward Place on Guns*, BLOOMBERG (Apr. 8, 2018, 9:00 AM), <https://www.bloomberg.com/opinion/articles/2018-04-08/larry-fink-s-blackrock-ends-up-in-an-awkward-place-on-guns> [<https://perma.cc/328J-JM48>]; Liz Moyer, *Student Activist David Hogg Calls for Boycott of Vanguard and Blackrock over Gunmaker Ownership*, CNBC (Apr. 17, 2018, 5:00 PM), <https://www.cnn.com/2018/04/17/student-activist-david-hogg-calls-for-boycott-of-vanguard-and-blackrock-over-gunmaker-ownership.html> [<https://perma.cc/3TZ5-JBJY>] (noting some activists' calls to boycott BlackRock and other index fund providers).

²⁹ See Amir Amel-Zadeh & George Serafeim, *Why and How Investors Use ESG Information: Evidence from a Global Survey*, 74 FIN. ANALYSTS J. 87, 93–95 (2018) (finding 34.4% of investors in the survey used full integration; again, U.S. investors lagged Europeans, with only 27.1% of the former using engagement strategies, and 48.1% of the latter); Robert G. Eccles et al., *How to Integrate ESG into Investment Decision-Making: Results of a Global Survey of Institutional Investors*, 29 J. APPLIED CORP. FIN. 125, 125–26 (2017) (finding only twenty-one percent utilized this strategy in a global study of asset owners and managers).

governance.”³⁰ Other active ESG strategies require portfolio companies to post minimum performance on ESG factors for inclusion in a fund or include leading ESG companies in a fund to tilt its overall composition in that direction.³¹ Still others develop thematic ESG investment products like clean energy, water, or other specialized investment funds. The AB Sustainable Global Thematic A Fund, for example, “identifies sustainable investment themes that are broadly consistent with achieving the United Nations Sustainable Development Goals.”³² Passive ESG funds rely on specially-designed ESG or sustainability indices to build their offerings, and will be discussed in more detail in Section I.B.

In addition to using various strategies to incorporate ESG factors into investment selection, ESG funds also practice engagement.³³ They utilize their power as shareholders—to vote for directors, on fundamental transactions and shareholder proposals, make shareholder proposals, and more informal efforts to influence management—to drive ESG changes in investee companies.³⁴ To some degree, as most ESG funds are composed of equity securities,³⁵ they cannot help engaging as they are called upon to vote their shares. Many ESG fund sponsors, however, see

³⁰ Morgan Stanley Institutional Fund, Inc., Summary Prospectus (Form 497K) (Apr. 30, 2018).

³¹ See Amel-Zadeh & Serafeim, *supra* note 29, at 93–95 (describing these strategies and reporting relatively lower levels of use than engagement and full integration, as reported by survey participants); Eccles et al., *supra* note 29, at 125–26 (reporting greater use of such techniques, thirty-seven percent for best-in-class selection and twenty-nine percent for thematic investing, in a global study of asset owners and managers).

³² AB Sustainable Glob. Thematic Fund, Summary Prospectus (Form 497K) (Oct. 31, 2018).

³³ See Amel-Zadeh & Serafeim, *supra* note 29, at 94–95 (finding 37.1% of global investors utilizing engagement strategies, though this finding was dominated by European investors; only 27.1% of US investors reported using this strategy, while 40.2% still used negative screening; 48.1% of European investors in the study utilized engagement); Eccles et al., *supra* note 29, at 125–26 (reporting twenty-one percent of respondents used engagement strategies in a global study of asset managers and asset owners who either implemented ESG investing already or planned to do so, while forty-seven percent used negative screening).

³⁴ See Sean J. Griffith, *Opt-In Stewardship: Toward an Optimal Delegation of Mutual Fund Voting Authority*, 98 TEX. L. REV. (forthcoming 2020) (manuscript at 6–7) (on file with author) (describing the “rise of stewardship”).

³⁵ See MORNINGSTAR 2020, *supra* note 1 (noting that while there is growth in fixed income sustainable funds, they still represent a relatively small slice of the market); see also MORNINGSTAR, PASSIVE SUSTAINABLE FUNDS: THE GLOBAL LANDSCAPE 5 (2018) [hereinafter MORNINGSTAR, PASSIVE SUSTAINABLE FUNDS], https://www.morningstar.com/lp/passive-esg-landscape?cid=RED_RES0002 (noting “embryonic” stage of development of the passive sustainable fixed-income market).

engagement beyond voting as an important component of their ESG orientation.³⁶ For example, Calvert, sponsor of several ESG funds in our sample, describes engagement as a key part of “how we’re different,” explaining that by “combining our proprietary research models with a structured corporate engagement framework, we work toward building sustainable long-term value in both the companies we invest in and our clients’ portfolios.”³⁷

Table 1 below illustrates different ESG investment strategies, as stated in funds’ investment strategy disclosures.

Table 1: ESG Investment Strategies

Category: ESG Scoring/ Screening	Ex: Vanguard FTSE Social Index ³⁸
ESG attributes of companies are scored and higher scoring companies are selected for investment or inclusion in an index. Conversely, non-ESG attributes (i.e., tobacco, armaments, etc.) may exclude a company from investment.	
Category: ESG Integration	Ex: Morgan Stanley Inst. Global Opp. ³⁹
Considering ESG factors as part of the valuation process for every investment decision.	
Category: ESG Active Governance	Ex: Calvert Equity Fund ⁴⁰

³⁶ Engagement also enables non-ESG branded funds to respond to ESG concerns in their investment portfolios. Indeed, engagement is likely to be the *only* available strategy for passive funds locked into non-ESG indexes to address ESG issues in their portfolios.

³⁷ *How We’re Different*, CALVERT, <https://www.calvert.com/how-we-are-different.php> [<https://perma.cc/VVK3-TN62>].

³⁸ Vanguard FTSE Soc. Index Fund, *supra* note 27.

The Index is market-capitalization-weighted and includes primarily large- and mid-cap U.S. stocks that have been screened for certain criteria related to the environment, human rights, health and safety, labor standards, and diversity. The Index excludes companies . . . involved with weapons, tobacco, gambling, alcohol, adult entertainment, and nuclear power.

Id.

³⁹ “The investment process integrates analysis of sustainability with respect to disruptive change, financial strength, environmental and social externalities and governance (also referred to as ESG).” Morgan Stanley Institutional Fund, Inc., *supra* note 30.

⁴⁰ “[R]esearch is guided by The Calvert Principles for Responsible Investment, which provide a framework for considering environmental, social and governance (“ESG”) factors that may affect investment performance.” Calvert Equity Fund, Summary Prospectus (Form 497K) (Feb. 1, 2018).

Voting in support of ESG favorable resolutions through proxy voting, propose ESG favorable shareholder resolutions, and engage management on ESG related issues.	
Category: ESG Operationalized Portfolio Companies	Ex: AB Sustainable Global Thematic A ⁴¹
ESG-focused theme such as clean water, clean energy, solar, or sustainable development goals.	

It still remains difficult to conduct industry-wide studies because ESG investing practices are so wide-ranging, and costs of utilizing these strategies can be high,⁴² but data showing ESG investing need not sacrifice returns—and indeed may increase them—is beginning to mount. Studies have found that incorporating a wide array of ESG investment strategies, like those identified above, outperforms negative screening alone.⁴³ In a comparison of portfolios using ESG factors with non-ESG portfolios, the former often outperformed the latter, and provided lower volatility and risk.⁴⁴ An influential study of firm performance also found that “firms with strong ratings on material sustainability topics outperform firms

⁴¹

The Adviser identifies sustainable investment themes that are broadly consistent with achieving the United Nations Sustainable Development Goals. Examples of these themes may include energy transformation, resource preservation, equality and opportunity, and improving human health and safeguarding lives, and the themes are expected to change over time based on the Adviser’s research. In addition to this “top-down” thematic approach, the Adviser also uses a “bottom-up” analysis of individual companies, focusing on prospective earnings growth, valuation, and quality of company management and on evaluating a company’s exposure to environmental, social and corporate governance (“ESG”) factors.

AB Sustainable Glob. Thematic Fund, *supra* note 32.

⁴² See, e.g., Michael Cappucci, *The ESG Integration Paradox*, 30 J. APPLIED CORP. FIN. 22, 23–26 (2018).

⁴³ See, e.g., Gunnar Friede et al., *ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies*, 5 J. SUSTAINABLE FIN. & INV. 210 (2015); Michael L. Barnett & Robert M. Salomon, *Beyond Dichotomy: The Curvilinear Relationship Between Social Responsibility and Financial Performance*, 27 STRATEGY MGMT. J. 1101 (2006) (collecting studies reaching contradictory conclusions and arguing that the divergence can be explained in part by the variation in methods used by different socially responsible investing techniques).

⁴⁴ See Tim Verheyden et al., *ESG for All? The Impact of ESG Screening on Return, Risk, and Diversification*, 28 J. APPLIED CORP. FIN. 47, 50–51 (2016).

with poor ratings on these topics.”⁴⁵ A metastudy of over two thousand studies of ESG investment performance concluded that “the business case for ESG investing is empirically well founded” and that “[i]nvesting in ESG pays financially.”⁴⁶

B. *Passive ESG*

The latest development in ESG investing is its combination with passive strategies tracking indices to offer investors both diversification and competitive pricing.⁴⁷ Unlike active funds, in which fund managers seek to pick winning investments and avoid losing ones as they construct their portfolios, passive investments utilize an externally created index and map their portfolios to it as much as possible. For example, the iShares Core S&P 500 ETF seeks to match its portfolio to the S&P 500. Fund returns track those of the underlying index, and costs are reduced by eliminating much of the need for research and expertise in portfolio construction (the “active” part of active management).

Passive investing is a huge trend. Fund houses launched over six hundred new index funds in 2017 and added \$223 billion in net cash flows to index mutual funds.⁴⁸ The trend continued in 2018 with \$207 billion of new money in passive U.S. funds (\$174 billion of which came out of active funds).⁴⁹ Market experts predicted the passive market would exceed actively managed funds by 2024, but it happened in September

⁴⁵ Mozaffar Khan et al., *Corporate Sustainability: First Evidence on Materiality*, 91 ACCT. REV. 1697, 1716 (2016).

⁴⁶ Friede et al., *supra* note 43, at 212.

⁴⁷ See Jill E. Fisch et al., *The New Titans of Wall Street: A Theoretical Framework for Passive Investors*, 168 U. PENN. L. REV. 17, 30 (2019). Professors Fisch, Hamdani, and Davidoff Solomon describe passive strategies as exploding to “the point where there are now more indexes than publicly traded U.S. stocks.” *Id.* at 31. In addition to tracking indices, passive strategies may convert traditional active investment into a rules-based approach, or strategies that combine eighty percent passive with twenty percent active strategies. *See id.* The proliferation of passive and passive-like strategies dilutes the concept beyond the point of a singular definition or consensus. *See id.*

⁴⁸ See INV. CO. INST., 2018 INVESTMENT COMPANY FACT BOOK 75–76 (2018), https://www.ici.org/pdf/2018_factbook.pdf [<https://perma.cc/AT5E-GW4F>].

⁴⁹ *Morningstar Reports U.S. Mutual Fund and ETF Asset Flows for Full-Year and December 2018*, MORNINGSTAR (Jan. 17, 2019), <https://newsroom.morningstar.com/newsroom/news-archive/press-release-details/2019/Morningstar-Reports-US-Mutual-Fund-and-ETF-Asset-Flows-for-Full-Year-and-December-2018/default.aspx> [<https://perma.cc/DS8Y-VY4M>].

2019.⁵⁰ Recently, passive funds capture seventy percent of new money in markets.⁵¹ Passive ESG funds coming online track fledgling indices of leading ESG companies, offering investors a lower-cost and seemingly less risky alternative to active management while still pursuing ESG excellence. As noted above, they now compose nearly a third of the sustainable funds market.⁵²

Exchange-traded funds—ETFs—are a passive investment product permutation with shares, as the name suggests, traded on an exchange.⁵³ Trading fund shares on an exchange allows for price fluctuations and trading throughout the day, as compared to the end of day pricing and trade clearing with traditional mutual funds. Many, but not all, ETFs track an index.⁵⁴ The Investment Company Institute (ICI) valued the 2019 U.S. ETF market at \$4.4 trillion in assets comprising sixteen percent of net investment company assets.⁵⁵ The ETF market is highly

⁵⁰ See, e.g., Trevor Hunnicutt, *Index Funds to Surpass Active Fund Assets in U.S. by 2024*: Moody's, REUTERS (Feb. 2, 2017, 9:31 AM) <https://www.reuters.com/article/us-funds-passive/index-funds-to-surpass-active-fund-assets-in-u-s-by-2024-moodys-idUSKBN15H1PN> [<https://perma.cc/L3B7-XBEV>]; John Gittelsohn, *End of Era: Passive Equity Funds Surpass Active in Epic Shift*, BLOOMBERG (Sept. 11, 2019, 11:21 AM), <https://www.bloomberg.com/news/articles/2019-09-11/passive-u-s-equity-funds-eclipse-active-in-epic-industry-shift> [<https://perma.cc/6FPU-8XA5>].

⁵¹ See MORNINGSTAR, U.S. FUND FEE STUDY (2018), <https://www.morningstar.com/lp/annual-us-fund-fee-study>; see also INV. CO. INST., *supra* note 48, at 41.

⁵² See MORNINGSTAR, *supra* note 3, at 8.

⁵³ See SEC, INVESTOR BULLETIN: EXCHANGE-TRADED FUNDS (ETFs) 1 (2012), <https://www.sec.gov/investor/alerts/etfs.pdf> [<https://perma.cc/HJH3-L9L2>]. Another key feature of ETFs is that the trading price of fund shares fluctuates throughout the day, as opposed to once-a-day priced NAV for traditional mutual funds. See *id.* at 2. The trading price of an ETF share may be above or below the NAV for the underlying fund assets. See INV. CO. INST., *supra* note 48, at 85.

⁵⁴ See INV. CO. INST., *supra* note 48, at 87–88. Index-based ETFs use several methods such as (1) index plus tracking of index through market capitalization, (2) benchmarking using additional factors like sales or book value, and (3) factor-based metrics that include screening indexes, weighting, and further customization to achieve various investment strategies (diversification, low volatility, market alignment or variation, etc.). See *id.*

⁵⁵ INV. CO. INST., 2020 Investment Company Fact Book 83 (2020), https://www.ici.org/pdf/2020_factbook.pdf [<https://perma.cc/QPG3-33S5>] (valuing the ETF market at \$4.4 trillion year end 2019); INV. CO. INST., *supra* note 48, at 86 (stating a similar valuation for 2017); see also M. Szmigiera, *Total Net Assets of Exchange Traded Funds (ETFs) in the United States from 2002 to 2018*, STATISTA (May 10, 2019), <https://www.statista.com/statistics/295632/etf-us-net-assets> [<https://perma.cc/6G6M-KR3G>].

concentrated.⁵⁶ In November 2018, iShares ETF funds experienced the highest monthly inflows out of the entire ETF market with \$25.3 billion of new investment dollars.⁵⁷ Two of iShares' ESG-focused funds (iShares Core MSCI Emerging Markets and iShares Edge MSCI Minimum Volatility) contributed the strongest inflows.⁵⁸ Other ETF providers are likewise generating new ESG ETF offerings.

Specially crafted ESG indices are the backbone of passive ESG funds. For example, along with its negative screen, the Vanguard FTSE Social Index relies on an index developed by FTSE that "is market-capitalization weighted and includes primarily large- and mid-cap U.S. stocks that have been screened for certain criteria related to the environment, human rights, health and safety, labor standards, and diversity."⁵⁹ Indices created by MSCI are also quite popular. For example, the iShares MSCI USA ESG Select ETF tracks MSCI's USA Extended ESG Select Index, "which is an optimized index designed to maximize exposure to favorable environmental, social and governance ('ESG') characteristics, while exhibiting risk and return characteristics similar to the MSCI USA Index."⁶⁰ Interestingly, ESG indices can also include negative screens of their own. For example, the MSCI Index used to compose the iShares MSCI KLD 400 Social ETF specifically excludes companies with "significant involvement" in "alcohol, tobacco, gambling, civilian firearms, nuclear power, controversial weapons, nuclear weapons,

⁵⁶ See *Socially Responsible ETF Overview*, ETF.COM, <https://www.etf.com/channels/socially-responsible> [<https://perma.cc/72AG-C3NK>] (reporting AUM in the ninety-seven socially responsible ETFs trading in U.S. markets and showing eleven of the largest twenty are offered by iShares, as well as a dominant presence by Vanguard and Invesco).

⁵⁷ See *Morningstar Reports U.S. Mutual Fund and ETF Asset Flows for November 2018*, MORNINGSTAR (Dec. 21, 2018), <https://shareholders.morningstar.com/newsroom/news-archive/press-release-details/2018/Morningstar-Reports-US-Mutual-Fund-and-ETF-Asset-Flows-for-November-2018/default.aspx> [<https://perma.cc/GLN5-J933>].

⁵⁸ See *id.* The iShares 1-3 Year Treasury Bond, a non-ESG fund, is the third named fund contributing to the strong monthly inflows. See *id.* For more current figures on fund flows, see MORNINGSTAR, MORNINGSTAR U.S. FUND FLOWS: MODEST FLOW BOUNCE FOR U.S. STOCKS (2019) https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/Direct_Fund_Flows_Sep_2019_Final.pdf?cid=EMQ_&utm_source=eloqua&utm_medium=email&utm_campaign=&utm_content=19262 [<https://perma.cc/8CXP-GX2D>].

⁵⁹ Vanguard FTSE Soc. Index Fund, *supra* note 27.

⁶⁰ iShares MSCI USA ESG Select ETF, Summary Prospectus (Form 497K) (Aug. 31, 2018).

conventional weapons, adult entertainment and genetically modified organisms.”⁶¹

ESG indexed mutual funds and ETFs claim to combine two of the most powerful trends in investing: passive strategies and ESG. For investors looking for low-cost, guilt-free saving or wealth-building vehicles, they would seem the perfect solution. Further, with a reliable ESG index, fund houses can harness the return-enhancing value of ESG factors at manageable and marketable costs. But concerns about whether ESG investing can deliver on its tremendous promise, particularly in its low-regulation environment, persist in passive investing.

Passive vehicles’ reliance on indexing also introduces unique issues regarding index creation and utilization. In an index fund, it becomes important to consider how closely the fund actually tracks its accepted index. As portfolios deviate from the index, certainty about the fund’s ESG performance—at least as measured by the index selected—diminishes. This role for index providers can make them immensely powerful, but they are also intensely private.⁶² Inserting index providers into the ESG investment process increases its complexity and opacity for investors. These features of passive ESG funds make them a fascinating addition to the canvass as we unpack the challenges to realizing the goals of ESG investment.

C. *Our Study*

The literature on ESG investing combined with the fast-paced, multifaceted growth of the practice suggests there will be great variation in ESG investment products available on the market. Rather than react to this mere likelihood of variation, we examined key attributes of thirty-one top ESG funds on the market, along with a select group of non-ESG comparators in the same fund family. Our findings add specificity and substance to the arguments we address.

⁶¹ iShares MSCI KLD 400 Soc. ETF, Summary Prospectus (Form 497K) (Aug. 31, 2018).

⁶² Although metrics giant MSCI announced last year that it would make its ESG ratings publicly available, the methods by which these ratings are generated remains private. See Hazel Bradford, *MSCI ESG Ratings Now Publicly Available*, PENSIONS & INV. (Nov. 26, 2019, 2:22 PM), <https://www.pionline.com/esg/msci-esg-ratings-now-publicly-available> [https://perma.cc/JJ56-JHWS].

Our study contained three distinct groups: ESG Funds, ESG Passive Funds (index and ETF, collectively ESGP), and non-ESG Comparison Funds.⁶³ To generate our list⁶⁴ of the “top” ESG funds, we combined 2017 AUM⁶⁵ with 2017 annual returns⁶⁶ and Morningstar sustainability ratings.⁶⁷ This list captured three passive funds that we transferred to our ESGP Funds list, leaving seventeen in our ESG Funds sample. To generate the other eleven ESGP Funds, we used a Morningstar report of the top US Passive Sustainable Funds,⁶⁸ which is also based on 2017 year-end data. For our non-ESG Comparison Funds, we researched the fund families in our ESG Funds and ESGP Funds samples to identify a similar asset-class mutual fund or ETF product without an ESG component. There are seven funds in our non-ESG Comparison Funds sample. Appendix I lists the funds we review in this Article.

To investigate how ESG is being operationalized, our study observed and compared five key attributes of the funds in our samples. We reviewed the ESG and ESGP Funds’ investment strategy disclosures to identify how and how thoroughly these funds describe their ESG investment approaches. We compared fund fees across the ESG and ESGP Fund samples, and in comparison to industry standard fees,⁶⁹ to determine how inclusion of ESG considerations impacts the cost of investing. Fund portfolio holdings and voting records on ESG shareholder proposals provided insights on distinctiveness. Do ESG and ESGP Funds invest in different portfolio companies than non-ESG funds? Are they more willing to oppose management in support of shareholder proposals geared toward enhancing portfolio company ESG

⁶³ See *infra* Appendix I.

⁶⁴ There is not widespread consensus of the “top” ESG funds because it depends on preference for type of ESG impact, how to define ESG, and how to balance with financial returns. After exhausting our research skills in trying to unearth a pre-existing list, we opted to compile our own.

⁶⁵ See MORNINGSTAR, *supra* note 3.

⁶⁶ *Id.*

⁶⁷ *Id.*; see also *Morningstar Sustainability Rating*, MORNINGSTAR (Aug. 24, 2016), <https://www.morningstar.com/articles/745467/morningstar-sustainability-rating.html> [<https://perma.cc/58FW-8UFH>] (explaining Morningstar’s sustainability ratings).

⁶⁸ See MORNINGSTAR, *PASSIVE SUSTAINABLE FUNDS*, *supra* note 35, at 16.

⁶⁹ We use the market average here instead of a direct comparison to our non-ESG Comparison Funds primarily because of the small size (seven) of this sample. In addition, the inclusion of emerging market funds in the non-ESG Comparison sample would distort the fee comparison point we want to make here, which is that ESG-branded products impose additional fees. From this point, we hope to explore and prompt readers to consider when that fee is worth it.

performance? Finally, we considered the tracking errors posted by ESGP Funds. Tracking error reveals the difference between the composition of a passively managed mutual fund or ETF and the underlying index against which it is constructed. As ESGP Funds are constructed against indices of high-performing ESG companies, larger tracking errors indicate alternative (lesser? greater?) ESG performance, with other consequences.

We collected our data primarily from fund disclosures available on EDGAR after filing with the Securities Exchange Commission (SEC), including the Form 497K Summary Prospectus, which discloses funds' investment strategies and risks, Form N-CSR, which reports fund holdings, and Form N-PX, which reports fund votes. We also make use of fund websites and publicly available mutual fund data compiled by financial data websites such as Morningstar. Given our small sample size, our data points are illustrative and not conclusively descriptive of the entire ESG market. We provide our data with the intent to contextualize the conversation. Our results and analysis appear below.

1. Investment Strategies

As a first cut, investors must determine whether an investment's combination of ESG strategy, ESG performance, financial return, and cost is suitable for them. While this is a familiar task for all investors—to pick the asset best suited to your risk tolerance and financial needs—the burden of the task is increased under the ESG mantle. Typical research tools include the summary (or full) prospectus, fund website, third party financial sites like Morningstar, or materials provided through an employer-sponsored defined contribution plan. Traditional investors spend little time with these materials, but perhaps ESG investors are more motivated.

Unfortunately, even the most motivated of investors will struggle to unpack what ESG means for a particular fund in a meaningful way. ESG funds' investment strategy statements are a little longer than non-ESG funds (by approximately eighty words), especially with ESGP funds (over two hundred additional words on average) likely accounting for the additional ESG discussion. This promising finding reveals little in terms of substance, however. ESG investment strategy statements vary widely

from silence, to generic,⁷⁰ to moderate⁷¹ and specific statements. For example, the JP Morgan Emerging Markets Equity A 2018 filing investment strategy statement contains no ESG-specific disclosure.⁷² In the 608-word investment description, zero are devoted to describing how it is an ESG fund. The Neuberger Berman Socially Responsible Investment fund provides an example of a specific disclosure, with over seventy percent of the entire disclosure devoted to ESG. It states:

[T]he Portfolio Managers look for those [portfolio companies] that show leadership in environmental, social and governance considerations, including progressive workplace practices and community relations. In addition, the Portfolio Managers typically look at a company's record in public health and the nature of its products. The Portfolio Managers judge firms on their corporate citizenship overall, considering their accomplishments as well as their goals. While these judgments are inevitably subjective, the Fund endeavors to avoid companies that derive revenue from gambling or the production of alcohol, tobacco, weapons, or nuclear power. The Fund also does not invest in any company that derives its total revenue primarily from non-consumer sales to the military. Please see the Statement of Additional Information for a detailed description of the Fund's ESG criteria. Although the Fund

⁷⁰ See e.g., Vanguard FTSE Soc. Index Fund, *supra* note 27 (including in its disclosed investment strategy that “[t]he Index is market-capitalization weighted and includes primarily large- and mid-cap U.S. stocks that have been screened for certain criteria related to the environment, human rights, health and safety, labor standards, and diversity”).

⁷¹ See e.g., iShares MSCI KLD 400 Soc. ETF, *supra* note 61 (“[M]arket capitalization index designed to target U.S. companies that have positive environmental, social and governance (‘ESG’) characteristics. As of April 30, 2018, the Underlying Index consisted of 403 companies identified by MSCI Inc. (the ‘Index Provider’ or ‘MSCI’) . . . MSCI analyzes each eligible company’s ESG performance using proprietary ratings covering ESG criteria. Companies that MSCI determines have significant involvement in the following businesses are not eligible for the Underlying Index: alcohol, tobacco, gambling, civilian firearms, nuclear power, controversial weapons, nuclear weapons, conventional weapons, adult entertainment and genetically modified organisms.”).

⁷² JPMorgan Emerging Mkts. Equity Fund, Summary Prospectus (Form 497K) (Mar. 1, 2018).

invests primarily in domestic stocks, it may also invest in stocks of foreign companies⁷³

In the middle of the two extremes are generic and moderate statements of ESG commitment. The Parnassus Endeavor Investor disclosure exemplifies a generic statement, providing that “The Adviser also takes environmental, social and governance (‘ESG’) factors into account in making investment decisions.”⁷⁴ TIAA-CREF Social Choice Equity Institutional offers an example of a moderate ESG disclosure describing specific attributes of the environmental (E), social (S), and governance (G) factors contributing to portfolio selection.⁷⁵

Examining the ESGP Funds sample, we find a similar range of silence to specific disclosure types. In the 2018 sample, one fund was silent, devoting zero words in its statement of investment strategy to describe its ESG specific investment approach, but that fund in 2019 changed it to a generic discussion of ESG considerations. Praxis funds in the same family include identical disclosures of the fund family’s ESG strategy. Such boilerplate provides some ESG information but does little to distinguish the different ESG strategies offered between the Praxis funds for consumers looking to understand their range of ESG investment options. With other fund families, like iShares, we observe variation between the strategy disclosures of different passive ESG funds within the family. For example, the iShares MSCI ACWI Low Carbon Target ETF 497K disclosure defines two dimensions of carbon exposure (“carbon emissions and potential carbon emissions from fossil fuel reserves”), describes carbon scoring, identifies the underlying index (MSCI), and further explains the portfolio construction.⁷⁶ The strategy disclosed for iShares MSCI USA ESG Select ETF is also specific, but specifically different, describing its use of “an optimized index designed to maximize exposure to favorable environmental, social and governance

⁷³ Neuberger Berman Equity Funds, Summary Prospectus (Form 497K) (Mar. 29, 2018) (containing 398 ESG words out of 562 total investment strategy words).

⁷⁴ Parnassus Endeavor Fund, Summary Prospectus (Form 497K) (May 1, 2018) (containing sixteen ESG words out of a 384-word investment strategy statement, therefore dedicating just 4.1% of the investment strategy disclosure to ESG).

⁷⁵ TIAA-CREF Soc. Choice Equity Fund, Summary Prospectus (Form 497K) (Mar. 1, 2018) (containing only seventy-seven ESG words out of a 668-word disclosure).

⁷⁶ iShares MSCI ACWI Low Carbon Target ETF (Form 497K) (Nov. 29, 2018).

(‘ESG’) characteristics, while exhibiting risk and return characteristics similar to the MSCI USA Index” and further detailing the index’s methodology.⁷⁷ Disclosures for both funds, across both years, caution that the underlying index includes large- or mid-capitalized firms with concentrations in the financial and technology sectors—statements that come to life in our holdings data.⁷⁸ The Green Century MSCI International Index Fund’s filing, another specific ESG disclosure, likewise describes the underlying index composition utilized, as well as the fund’s environmental focus on carbon exposure through fossil fuels, and exclusionary screens applied to the portfolio.⁷⁹

ESG investment strategies and the disclosures describing those strategies to investors vary significantly between funds. What is the harm in an undefined and un-demarcated ESG scope? The vagueness and variation in ESG funds empower fund managers. ESG fund strategy statements can be broad and vague, committing to, for example, “invest[] . . . in forward-thinking companies with more sustainable business models”⁸⁰ or “employ[] a sustainable rating system based on its own, as well as third-party, data to identify issuers believed to present low risks in ESG.”⁸¹

Beyond identifying the three qualifying attributes—“E,” “S,” and “G”—when funds discuss ESG investing, they do so using different definitions, qualifications, and metrics. TIAA-CREF’s dedicated ESG fund describes ESG as follows:

The Fund’s investments are subject to certain ESG criteria. The ESG criteria are implemented based on data provided by independent research vendor(s). All companies must meet or exceed minimum ESG performance standards to be eligible for

⁷⁷ iShares MSCI USA ESG Select ETF, *supra* note 60.

⁷⁸ iShares MSCI KLD 400 Social ETF, *supra* note 61 (“[M]arket capitalization index designed to target U.S. companies that have positive environmental, social and governance (‘ESG’) characteristics. As of April 30, 2018, the Underlying Index consisted of 403 companies identified by MSCI Inc. (the ‘Index Provider’ or ‘MSCI’) . . . MSCI analyzes each eligible company’s ESG performance using proprietary ratings covering ESG criteria. Companies that MSCI determines have significant involvement in the following businesses are not eligible for the Underlying Index: alcohol, tobacco, gambling, civilian firearms, nuclear power, controversial weapons, nuclear weapons, conventional weapons, adult entertainment and genetically modified organisms.”).

⁷⁹ Green Century Funds, Statement of Additional Information (Form 497K) (May 15, 2017).

⁸⁰ Pax World Funds Series Tr. I, Registration Statement (Form 485A) (Feb. 1, 2018).

⁸¹ Amana Income Fund, Summary Prospectus (Form 497K) (Sept. 28, 2018).

inclusion in the Fund. The evaluation process favors companies with leadership in ESG performance relative to their peers. Typically, environmental assessment categories include climate change, natural resource use, waste management and environmental opportunities. Social evaluation categories include human capital, product safety and social opportunities. Governance assessment categories include corporate governance, business ethics and government and public policy. How well companies adhere to international norms and principles and involvement in major ESG controversies (examples of which may relate to the environment, customers, human rights and community, labor rights and supply chain, and governance) are other considerations.

The ESG evaluation process is conducted on an industry-specific basis and involves the identification of key performance indicators, which are given more or less relative weight compared to the broader range of potential assessment categories. Concerns in one area do not automatically eliminate an issuer from being an eligible Fund investment. When ESG concerns exist, the evaluation process gives careful consideration to how companies address the risks and opportunities they face in the context of their sector or industry and relative to their peers. The Fund will not generally invest in companies significantly involved in certain business activities, including but not limited to the production of alcohol, tobacco, military weapons, firearms, nuclear power and gambling products and services.⁸²

Even this extensive discussion leaves many open questions to the fund manager and its delegates. How far superior to a company's peers must its performance be to constitute "leadership"? It appears that no minimum level of E, S, or G performance is required; how does leadership in one arena compensate for poor performance in another? When, and on what basis, will the negative screen be ignored? Of course, part of the value of investing in a fund is relying on an expert's wisdom and expertise. Adding ESG issues to this domain, however, broadens this reliance and

⁸² TIAA-CREF Social Choice Intl. Equity Fund, Summary Prospectus (Form 497K) (Mar. 1, 2018).

increases fund managers' power, not only over investment and engagement decisions made on this basis, but also potentially over the attention and priority given to ESG issues (and ESG issues each independently) by portfolio companies. As these players motivated by financial return create demand for ESG metrics (or produce them in-house), these metrics will also be developed to identify return-protecting and palatable companies, but not necessarily transformative change.

Even when funds share a passive ESG strategy, a seeming niche of the market with considerable overlap, substantial variation persists. Because an ESG label does not represent a clear investment strategy, even when associated with passive funds, it primarily serves a branding function for the investing public. The market signal that a fund is "ESG" seems to be more about the normative "good" an investment can provide rather than signal how the investment works or the degree to which a fund even pursues ESG. A useful analogy may be to a fictional fund calling itself a "success" fund (something funds are not allowed to do). Investors may be drawn to the label and idea of success without having a clear understanding of why the fund may or may not achieve investment success. Market signals of this sort increase the burden on the investing public to decode the labels and differentiate the investment products offered.

In short, the ESG investment market now designs products with a range of investment strategies, varying levels of commitment to ESG, and fluid definitional boundaries around what counts as ESG. Important questions about how a fund operationalizes ESG remain after this review. The opacity of the ESG investment market imposes a significant burden on investors to distinguish between ESG investments and match their preferences to the appropriate ESG strategy and outcome (for them) within the range of options. With opacity comes unchallenged leeway for managers and index providers, all shielded from public review.

2. Fees

Cost is a key consideration in both choosing and designing investment products. Investors select products with fees they are willing to pay, and fund creators design products with fees that will make them competitive, yet profitable. Lower fees have been a tremendous force in the investment market, driving the rise of passive investing. Applying an

ESG lens necessarily introduces additional costs into portfolio construction. In active funds, managers must research and evaluate the ESG performance of potential portfolio companies and continue to assess them over time. In passive ESG funds, managers must purchase access to an index from an outside firm or dedicate resources to developing an index or rules-based model of their own. The cost of these extra burdens is likely passed along to ESG investors in the form of higher fees.

Our sample shows a range of fees associated with ESG investment products.⁸³ The average expense ratio is 1.09, but with a widely divergent range of fees from 0.18 (TIAA-Cref Social Choice Equity fund) to 1.47 (Domini Impact International fund). The range of fees for passive ESG funds also varied considerably with a low of 0.19 in the Calvert US Large Cap Core Responsible Index and the highs around 1.30 for funds targeted on international markets (Praxis International Index at 1.32) or specific sectors (Calvert Global Water at 1.28). The greatly reduced cost of executing passive strategies compared to active strategies, which require individual portfolio asset oversight and monitoring, account for the different fees.⁸⁴ Consider average mutual fund fees of 0.51–0.59 for all mutual funds compared to 0.09 for index equity funds.⁸⁵ Our ESGP Funds average lower fees (0.68) than the active ESG Funds sample (1.09 fees), but not this low. Table 2 below reports fees in our review of ESG and ESGP Funds.

⁸³ Data supporting this paragraph is listed in Table 2.

⁸⁴ See, e.g., Dana Anspach, *How Mutual Fund Expense Ratios Work*, BALANCE (Dec. 3, 2019), <https://www.thebalance.com/expense-ratios-paying-much-2388663> [https://perma.cc/7FLL-ME35].

⁸⁵ See INV. CO. INST., *supra* note 48, at 118, 123. A Morningstar report on 2017 fees based on a sample of 25,000 funds found the average expense ratio to be .52%. See MORNINGSTAR, *supra* note 51, at 1. Investor fund flows into lower-fee fund options, like indexes, drive average fees down. See *id.* at 7–8.

Table 2: 2018 ESG Fees⁸⁶

ESG Funds (Top 17)	Expense Ratio	ESGP	Expense Ratio
Pax Global Environmental Mkts Instl	0.98	Vanguard FTSE Social Index Inv.	0.2
Morgan Stanley Inst Global Opp I	1.12	Calvert US Large Cap Core Rspng Idx I	0.19
Calvert Emerging Markets Equity I	1.27	iShares MSCI KLD 400 Social ETF	0.5
RBC Emerging Markets Equity I	1.13	PowerShares Water Resources ETF	0.62
AB Sustainable Global Thematic A	1.29	PAX MSCI EAFE ESG Leaders Index Instl	0.56
Amana Income Investor	1.12	iShares MSCI USA ESG Select ETF	0.5
Domini Impact International Equity Inv	1.47	Guggenheim S&P Global Water ETF	0.63
Eventide Gilead N	1.39	iShares MSCI ACWI Low Carbon Target ETF	0.2
Neuberger Berman Socially Rspns Inv	0.84	Calvert Global Water A	1.28
Parnassus Mid-Cap	0.99	Guggenheim Solar ETF	0.7
Hartford Schroders Emerging Mkts Eq I	1.50	Green Century MSCI International Index Fund - Institution	0.98
Amana Growth Investor	1.09	Praxis Growth Index Fund A	0.98
Calvert Equity A	1.06	Praxis International Index A	1.32
TIAA-CREF Social Choice Eq Instl	0.18	Praxis Value Index A	.94
Parnassus Endeavor Investor	0.95		
JPMorgan Emerging Markets Equity A	1.35		
Parnassus Core Equity Investor	0.87		
Average expense ratio	1.09		.68

In addition to revealing considerable variation across all ESG funds, we find ESGP Funds charge lower fees than those using active strategies, but higher fees than average non-ESG index products. Recent Morningstar research found similar results, reporting that while sustainable funds are competitive on fees, sustainable ETFs fees tended to be higher than average.⁸⁷ These findings undermine the low-fee value

⁸⁶ This table reflects 2018 fees only. We reviewed 2019 fees and found consistent results that the ESG funds are higher, on average, than non-ESG funds and that ESGP funds, while lower than ESG active funds, are still higher than non-ESG traditional passive funds.

⁸⁷ See MORNINGSTAR, *supra* note 3, at 27; see also MORNINGSTAR, PASSIVE SUSTAINABLE FUNDS, *supra* note 35, at 1, 13, 18 (reporting findings that sustainable index funds in the United States and Europe are more expensive than standard index products). Note that the fees reported

proposition of passive strategies, but are easy to understand. Higher fees in passive ESG investing are likely reflect the new and different metrics on which ESG index products rely compared to traditional passive funds.

To obtain market-worthy metrics, mutual fund families integrating ESG factors must invest in new personnel and expertise to create the metrics in-house or secure metrics or index information from external providers for a (presumably hefty)⁸⁸ price. MSCI, which supplies indices for more of the ESG index funds in our sample than any other provider, offers a “suite of over 1,000 equity and fixed income ESG Indexes . . . designed to represent [the performance of] some of the most prevalent ESG strategies.”⁸⁹ MSCI claims to “help institutional investors more effectively benchmark to ESG investment performance well as manage, measure and report on ESG mandates.”⁹⁰ The Vanguard FTSE Social Index Fund, the largest passive ESG fund with quadruple the assets under management (four billion dollars) of any other fund in our sample,

in our paper are a small, nonrepresentative sample of the ESG market and thus may be skewed higher as a result of the sample, inclusion of legacy sustainable funds, and different share class fees being reported (although we took institutional share class numbers whenever available).

⁸⁸ A 2017 report by Investment Week cites index fees ranging from £22,000–150,000 for the licensing fees and use of data. See Tom Eckett & Anna Fedorova, *Managers Reconsider Use of Index Providers amid ‘Eye-Watering’ Costs*, INV. WEEK (June 8, 2017), <https://www.investmentweek.co.uk/investment-week/news/3011594/managers-reconsider-use-of-index-providers-amid-eye-watering-costs> [<https://perma.cc/9NZ9-YXL6>]. Given the proprietary nature of the ESG indices there is little concern, at least now, of stealth indexing where active ESG funds mimic market-indexed funds and still charge a higher fee. See K.J. Martijn Cremers & Quinn Curtis, *Do Mutual Fund Investors Get What They Pay For? Securities Law and Closet Index Funds*, 11 VA. L. & BUS. REV. 31 (2016) (describing the costs and legal consequences of closet indexing).

⁸⁹ *ESG Investing*, MSCI, <https://www.msci.com/esg-integration> [<https://perma.cc/6Z2F-UVJM>]; see also MSCI, *MSCI ESG MULTI-ASSET CLASS ANALYTICS 4* (2018), <https://www.msci.com/documents/1296102/11039838/MSCI+ESG+Analytics+Brochure.pdf/e54eb02f-1c09-f394-3768-ec7a776f9973> [<https://perma.cc/7QHK-X34D>] (claiming MSCI is “the world’s largest provider of ESG research and data”).

⁹⁰ *MSCI ESG Indexes*, MSCI, <https://www.msci.com/esg-indexes> [<https://perma.cc/HNT9-KTQK>]; MSCI, *MSCI ESG SCREENED INDEXES: AN OFF-THE-SHELF APPROACH TO ESG SCREENS 3* (2019), <https://www.msci.com/documents/1296102/1636401/MSCI-ESG-Screened-Indexes-Brochure.pdf/ff64b0bc-f06e-298b-f84b-95814f193ed4> [<https://perma.cc/DC47-DD7Z>] (boasting that over \$250 billion in institutional, retail, and ETF assets are benchmarked to MSCI ESG Indexes). For a discussion of the concentration of the index industry and its resulting power, see Johannes Petry et al., *Steering Capital: The Growing Private Authority of Index Providers in the Age of Passive Asset Management*, REV. INT’L POL. ECON. 1 (2019), <https://www.tandfonline.com/doi/full/10.1080/09692290.2019.1699147> [<https://perma.cc/B788-W9AZ>].

relies on the FTSE4Good US Select Index, a market-capitalization weighted U.S. equity index that, as noted above, excludes “tobacco, alcohol, adult entertainment, firearms, gambling, [and] nuclear power” stocks.⁹¹ The index is produced by FTSE Russell, a leading global provider of indices that developed its first FTSE4Good Index products in 2001 and now offers numerous suites of ESG indices, across various strategies and asset classes.⁹² As does MSCI, FTSE Russell also offers ESG benchmarking and metrics products in addition to these proprietary indices.

At least with regard to some ESG products, fees diverge from market norms. This imposes a burden on investors to investigate fees and decide whether the blend of potential financial and non-financial returns from ESG investments—which is itself difficult to discern and assess—is sufficient to compensate them for higher costs. Further, as we document more below, there may be tension between low fees and high ESG impact. As large complexes, like iShares, continue to gain market share, there will be increasing ESG fee pressure—a financial positive that may lessen ESG impact.⁹³

3. Portfolio Holdings

Here we examine the portfolio companies in which ESG funds invest. The range of portfolio company holdings is consistent with the range of investment styles (United States vs. international; specific industry/sector vs. whole market, etc.) and the range of ESG commitment reflected in investment strategies. That disclaimer aside, the holdings reported in Appendix II may surprise even skeptics.

⁹¹ Vanguard FTSE Soc. Index Fund, *supra* note 27.

⁹² See FTSE RUSSELL, FTSE4GOOD INDEX SERIES 1 (2019), https://www.ftse.com/products/downloads/FTSE4Good-brochure.pdf?_ga=2.193271214.2070678876.1550678839-407133334.1550678839 [<https://perma.cc/4BV8-MVX5>] (describing origination and development of FTSE4Good Index); *FTSE ESG Index Series*, FTSE RUSSELL, <https://www.ftse.com/products/indices/esg> [<https://perma.cc/5ZEV-CFJ2>] (linking to information on the various ESG index series available from the firm).

⁹³ Gabriel Presler, *Sustainable Funds U.S. Landscape: 5 Takeaways from Our 2018 Report*, MORNINGSTAR (Feb. 19, 2019), <https://www.morningstar.com/blog/2019/02/19/esg-landscape.html> [<https://perma.cc/X4ME-L66C>] (“Behemoths like BlackRock and Vanguard bring increasing fee pressure into an area that has historically been associated with higher costs.”).

To explore portfolio holdings, we review the top holdings, as measured by percent of fund assets invested in a company.⁹⁴ For consistency and manageability, we capped all reported holdings at the top ten portfolio companies. While this is a small subset of holdings for a relatively small sample of funds, the information is still too diffuse and granular to get a sense of what companies are included in ESG funds. To focus our discussion, we researched each portfolio company and assigned it one of the following broad categories:

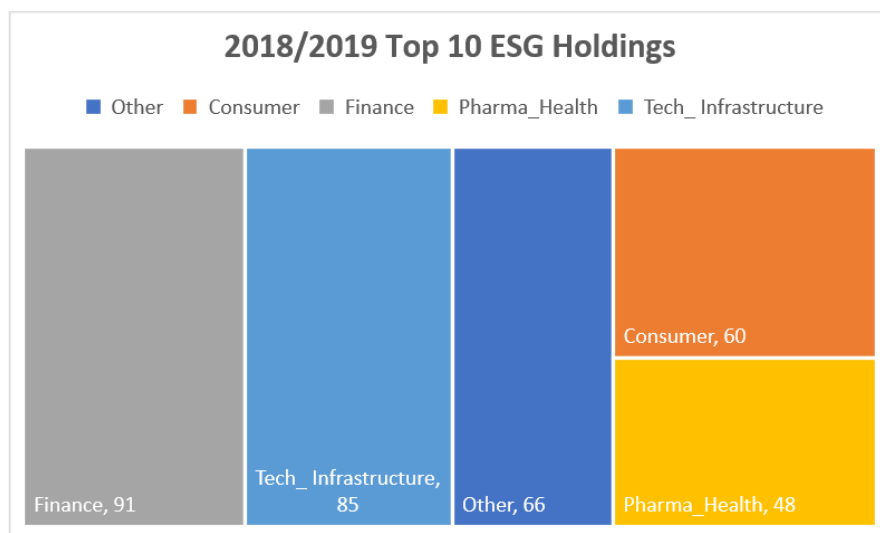
- *Financial services*: capital providers to individuals and businesses, insurance companies, credit card companies, and large financial institutions, such as Intercontinental Exchange, Inc.
- *Technology and tech infrastructure companies*: companies that make integrated technology software, hardware, or products including companies, such as Apple, Alphabet (Google's investment arm), Microsoft, Vodafone, AT&T, etc.
- *Consumer products and services*: companies making goods or providing goods (including retail) for individual consumption and use, such as Clorox, Hanes, Dollar General, Starbucks, Amazon, Alibaba, PepsiCo Inc., Wal-Mart, etc.
- *Pharmaceuticals and health*: companies manufacturing over the counter and prescription medicine for humans and animals, medical device companies, and pharmacies, such as Eli Lilly, Pfizer Inc., United Health Group, Inc., and CVS Health Corp.
- *Other*: companies focused on business operations, logistics, small component parts, the automobile, railroad, and energy industries, etc.

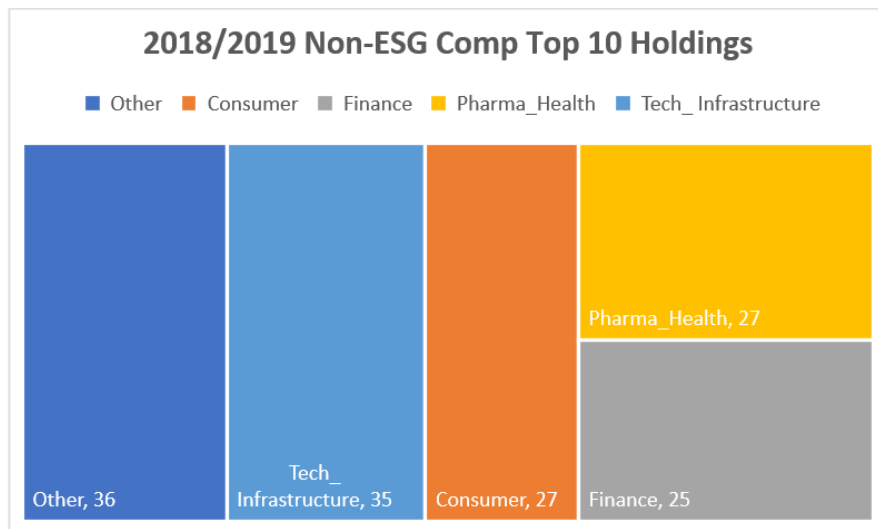
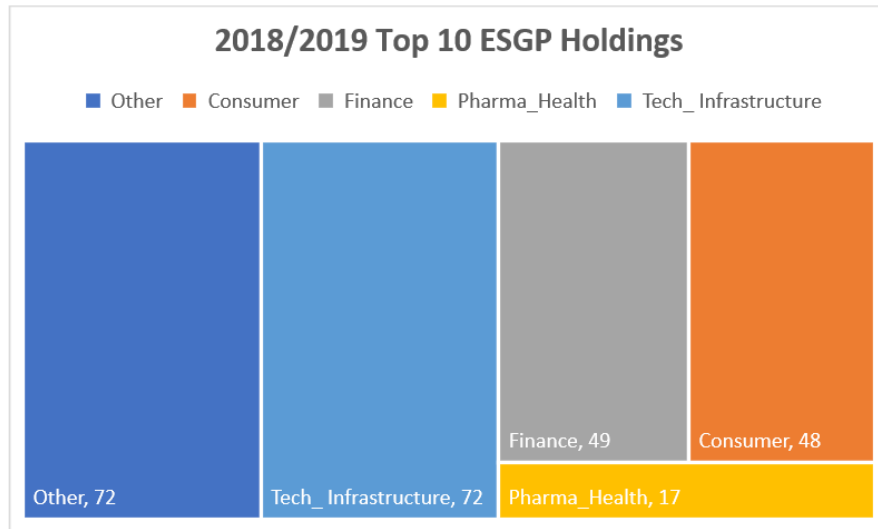
There are some companies for which the category assignment is reasonably debatable, such as 3M Co., which is assigned as a consumer product despite its wide range of operations. The category assignment reflects our predilection for post-it notes rather than a balance sheet or

⁹⁴ We report the top ten holdings of each fund in our sample, as reported in the fall of 2018. Holdings are listed in Appendix II, *infra*. Raw data is on file with authors.

operations analysis. Categorical assignments are intended to condense disparate information into a digestible, although imperfect, snapshot of the portfolio holdings for purposes of illustration, not causal analysis. The categories also reflect, in part, our interest in household names, which appeared repeatedly across both the four industry categories and the “other” category, in which clear examples of household name companies such as Walt Disney and Nissan Motor Co. Ltd. were common.

The following three charts report the distribution of the top ten portfolio company holdings in our broad categories across our three samples of funds in 2018–2019. This albeit rough view of portfolio holdings gives us a sense of what markets/sectors these funds invest in, allowing for rough comparisons of ESG fund portfolio construction to non-ESG funds. Although our ESG Funds and ESGP Funds samples reflect a wide range of ESG “commitments” and investment styles (international, domestic, growth, large cap, etc.), assigning each portfolio company to one of our broad categories yields industry distributions.





ESG funds hold more finance companies—its top weighted industry—than ESGP. Both ESG and ESGP heavily invest in the technology and infrastructure sectors. Both have similar exposures to consumer facing companies and pharmaceuticals or health care companies.

The “other” category—captures the largest share of top ten portfolio holdings in both ESGP Funds and non-ESG Comparison Funds sample.

As a catchall by design, it is important to unpack the range of firms included in this category to understand our findings. In reviewing the constituent firms assigned to the “other” category across our samples, one observation stands out. For non-ESG funds, the “other” category includes a concentration of traditional energy industry players and automobile manufacturers in the top ten holdings. In contrast, both company types are conspicuously absent from the top ten portfolio holdings (but not all holdings) of the ESG and ESGP Funds we studied.⁹⁵ If nothing else, ESG investments on the aggregate appear to provide differential exposure, at least in terms of depth, to the traditional energy and automobile sectors than their non-ESG competitors. Otherwise, the composition of the non-ESG Comparison funds looks similar to ESGP funds, with a greater emphasis on pharmaceuticals and health care.

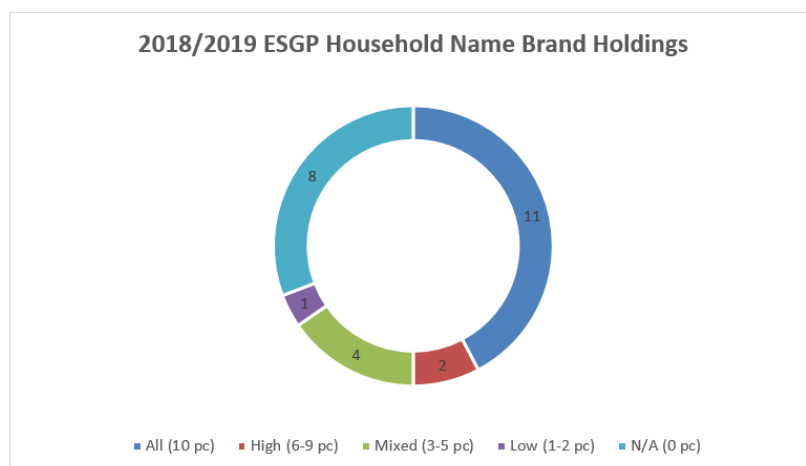
The other differences across the samples are less dramatic, but still worthy of discussion. Some are likely driven largely by the group of ESG funds that concentrate on a particular ESG theme or sector. For example, in the ESGP Funds sample, the “other” category is largely comprised (sixty-one percent) of portfolio companies held by sector/thematic ESG funds focused on water, clean energy, etc.,⁹⁶ and not held by non-ESG Comparison funds. When looking at 2018 data alone, we also saw differentiation on consumer services and products (more prevalent in non-ESG Comparison funds), but those differences mostly fall away when adding in 2019 data. Our sample included no funds built around an explicit consumer products/services theme, but it is possible that consumer-facing firms face especially significant pressure to engage in corporate social responsibility efforts, allowing overrepresentation among ESG fund portfolios.⁹⁷ ESG commitments can be a part of a brand identity and marketing strategy just as quality or price can be.

⁹⁵ For example, in 2019 iShares MSCI ACWI Low Carbon Target ETF held positions in oil companies, automobile manufacturers, and tobacco companies in addition to the standard financial and technology companies. See also Akane Otani, *ESG Funds Enjoy Record Inflows, Still Back Big Oil and Gas*, WALL ST. J. (Nov. 11, 2019, 4:29 PM), <https://www.wsj.com/articles/top-esg-funds-are-all-still-invested-in-oil-and-gas-companies-11573468200?mod=searchresults&page=1&pos=1> [<https://perma.cc/V9PQ-43ND>].

⁹⁶ There are no observable patterns driving the composition of the “other” category in our ESG Funds sample, although it also includes thematic funds.

⁹⁷ See N. Craig Smith, *Consumers as Drivers of Corporate Social Responsibility*, in THE OXFORD HANDBOOK ON CORPORATE SOCIAL RESPONSIBILITY 281, 297–98 (Andrew Crane et al. eds., 2008)

Our review of portfolio holdings across all three samples also revealed a strikingly consistent reliance on household name brand companies.⁹⁸ All samples have at least a handful of funds where all top ten holdings are household name brands. For example, in 2018, TIAA-CREF Social Choice Equity fund was entirely comprised of household name brands. As expected, the number is clearly higher in the non-ESG Comparison funds. The percentages of portfolio holdings with mixed or higher household name brand exposures is similar across the three samples with the highest in the non-ESG Comparison (eighty-six percent) and lowest in ESGP (sixty-five percent) and ESG in the middle (seventy-five percent).



(arguing that consumers are likely less important drivers of CSR among business-to-business firms).

⁹⁸ We defined household name brand in light of our subjective evaluation of a company's status. As noted above, we researched each portfolio company, and in that way possibly skewed our perception.

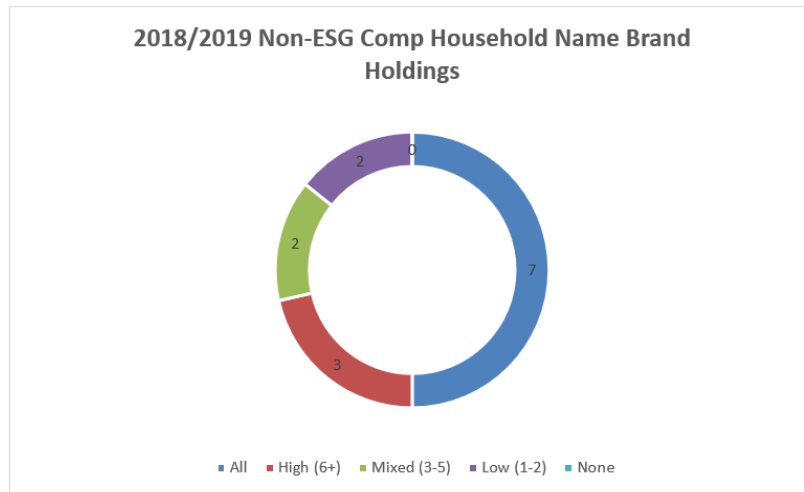
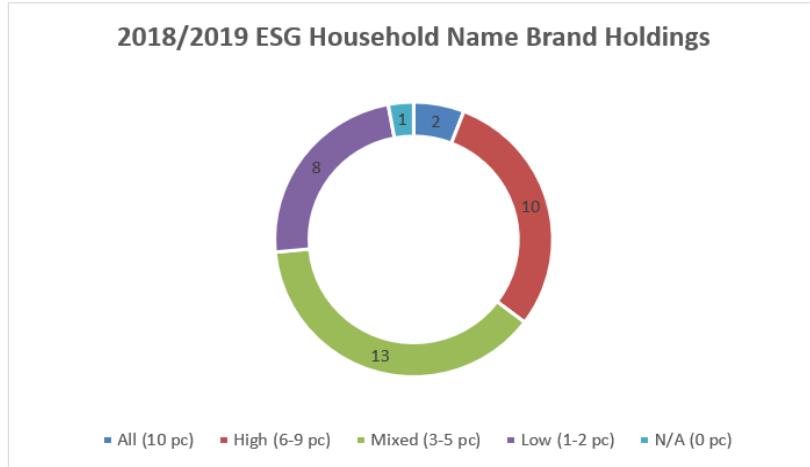


Table 3 provides readers with some instructive examples drawn from our household name brand analysis. It reports the household name companies in each category described above (aside from “other”) appearing among the top ten holdings of funds in our ESGP Funds sample. Numbers indicate totals; sample firms are listed in the second row, noting companies held by multiple funds. Household name brand holdings were consistent in 2018 and 2019. For readers seeking still greater detail, Appendix II lists the top ten portfolio company holdings (2018) for our entire sample: ESG Funds, ESGP Funds, and non-ESG Comparison Funds.

Table 3: Review of Top 10 2018 & 2019 “Household Name”
Holdings of ESGP Funds Sample

36 Banking & Finance	51 Technology & Infrastructure	43 Consumer Goods/Services	18 Pharma/Health Care
10 Banks (6 Bank of America) 7 JP Morgan 12 Credit Cards (Mastercard-5; Visa-7) 3 Citigroup 3 Blackrock 2 Insurance (Allianz)	10 Apple Inc. 17 Alphabet Inc. ⁹⁹ 11 Microsoft 6 Facebook 4 Intel (3); IBM (1) 4 Telecom (2 AT&T; 2 Verizon) 1 Salesforce	6 Amazon. com 8 Proctor & Gamble 6 Johnson & Johnson 2 Walmart 2 Alibaba 3 Soda (2 Pepsi; 1 Coke) 2 Nestle 6 Other	Proctor Gamble Merck & Co 3 Pfizer 2 Roche 3 UnitedHealth Care GlaxcoSmithKline 3 Other

We make no normative judgment about the inclusion of household name brands in a fund as a good indicator of ESG commitment or not, nor of the underlying merits of these portfolio companies’ performance on E, S, or G metrics.¹⁰⁰ Our observation instead is that, outside of thematic ESG funds such as those focusing on clean energy or water,¹⁰¹ there is little to distinguish between ESG branded funds and non-ESG branded funds with regard to recognizable ESG quality of their top portfolio companies. A simple specialist/generalist dichotomy may help explain the varied focus on name brand portfolio companies. Of the funds

⁹⁹ Many funds, such as iShares MSCI ACWI Low Carbon Target ETF held two different classes of Alphabet stock (class A and C) among its top ten holdings, which were counted twice. *Infra* Appendix II.

¹⁰⁰ Given the breadth of ESG implementation approaches, including integration of ESG risks and opportunities in decision making, the portfolios of ESG and non-ESG funds unsurprisingly overlap, especially as ESG integration is viewed as a tool of risk mitigation and return protection. See e.g., MORNINGSTAR, BETTER MINUS WORSE: EVALUATING ESG EFFECTS ON RISK AND RETURN (2020), <https://www.morningstar.com/lp/esg-as-a-factor> [<https://perma.cc/Y6DH-DT6C>] (reporting on the effects of ESG holdings in portfolio risk exposure and returns).

¹⁰¹ Passive ESG funds with a thematic focus, such as Calvert Global Water and Guggenheim Solar ETF funds, are comprised exclusively of companies outside of the mainstream. As noted earlier, all of these funds’ portfolio companies also fall into the “other” category, reflecting the overlap between the industry categories and the name brand distinction. *Infra* Appendix II.

that have mixed or low recognition, they are primarily sector-based ESG funds and international or emerging market-focused funds. The same is true of non-ESG fund holdings.

In this Section and as further documented in Appendix II, we observe mainstream investments and overlapping investments in particular portfolio companies such as Apple, Alphabet, Amazon, Bank of America, Facebook, and Microsoft, by funds in all three sample groups. These observations alone are not damning as to ESG commitment; we make no claim as to the ESG performance of the portfolio companies. We note the prevalence of mainstream investments in light of the range of disclosed ESG criteria and investment strategies. An investor looking to invest in a “good” ESG fund will struggle to distinguish between products based on the disclosures and on the top holdings when the ESG criteria are hard to discern and the holdings concentrated in mainstream companies.

Investors are responsible for understanding both the risk and the opportunity of any investment. Our observations raise questions about ESG market efficiency, however, when the information required to distinguish and assess various investment products is diffuse, disaggregated, and hard to interpret. Information asymmetry of this kind impedes ESG labels from carrying substantive information to investors, relegating its value again to branding and market signaling rather than investor education.

4. Voting

Voting patterns are another way to unpack the range of ESG options from which investors can choose. Voting is particularly important in passive funds for which purchases and sales are constrained by the need to track an underlying index. While shareholder engagement comprises informal attempts to influence portfolio company management, advancing shareholder proposals, and voting on both shareholder proposals and other matters raised by management, not all of these are transparent and frequently relevant to ESG investing. We therefore focus

on votes on shareholder proposals, many of which address ESG issues,¹⁰² and for which fund voting records are publicly disclosed.

Despite the availability of mutual fund and ETF votes, developing a sense of funds' voting activity is daunting. Funds file voting disclosures in text form, using various formats, and often running hundreds of pages. Searching is made more difficult by the common practice of including votes by multiple, similarly named funds in the same document. We amassed just two years (2018 and 2019) of data on our thirty-one funds,¹⁰³ and it required searching thousands of lines of disclosures by hand. Occasionally, this task was further complicated by vague descriptions of proposals on which funds vote. In the most striking example we encountered, the Amana Growth Fund 2019 disclosure lists merely “[c]onsider and vote upon one stockholder proposal” at Adobe annual meeting, reporting its vote against the proposal.¹⁰⁴ Only through review of another fund's description of votes at the same Adobe meeting were we able to discern the proposal in question concerned a report on the gender pay gap. The data we report below emerge from this arduous, but imperfect, process and should be understood as such.

Our review of the 2018 and 2019 voting records disclosed by funds in each of our three sample groups on ESG-related shareholder proposals generated results broadly aligned with our sense that investors get the ESG they are willing to pay for. Funds offered by large, generalist fund complexes were the only ones to consistently clash with ESG expectations. Vanguard's FTSE Social Index fund posted perhaps the

¹⁰² See, e.g., ROBERT KALB ET AL., ISS ANALYTICS, A PRELIMINARY REVIEW OF THE 2018 US PROXY SEASON 4–6 (2018), [https://www.isscorporatesolutions.com/file/documents/ics_a_preliminary_review_of_the_2018_us_proxy_season.pdf?elqTrackId=8bd378d423324ecdb189187cc8f09cb1&elq=e1fa6417035a49dea20d5c16f66c81d5&elqaid=969&elqat=1&elqCampaignId=\[https://perma.cc/6VB8-URNG\]](https://www.isscorporatesolutions.com/file/documents/ics_a_preliminary_review_of_the_2018_us_proxy_season.pdf?elqTrackId=8bd378d423324ecdb189187cc8f09cb1&elq=e1fa6417035a49dea20d5c16f66c81d5&elqaid=969&elqat=1&elqCampaignId=[https://perma.cc/6VB8-URNG]) (reviewing the 2018 proxy season, including ESG proposals as major components).

¹⁰³ The voting records are taken from Forms N-PX filed with the SEC in 2018 and 2019, reporting funds' votes cast during the 2018 and 2019 proxy seasons. We focused on votes in the top holdings assuming that funds may not have resources to devote to monitoring all proxy issues at all companies in which the fund invests, but also assuming that scarce proxy resources would be devoted to monitoring votes at companies topping funds' holdings lists. In addition to examining all votes at top portfolio companies, we analyzed every vote reported by each fund on three indicative categories of ESG issues as noted in Table 4, *infra*.

¹⁰⁴ Amana Mut. Funds Tr., Annual Report of Proxy Voting Record of Registered Management Investment Company (Form N-PX) (June 30, 2019).

most surprising voting history, opposing every shareholder proposal recommending climate change reporting and against dozens of proposals on gender pay equity, employee diversity reports and policies, and political spending disclosure.¹⁰⁵ The Hartford Schroders Emerging Market Equity Fund was also quite negative on the ESG issues it confronted. In 2018, it voted against two proposals on climate change, posted a mix of yes, no, and abstention votes on various diversity and gender pay equity proposals, and voted against five proposals to report on political spending. The three iShares ETFs in our sample, managed by passive investing giant BlackRock, seemed to shift their voting perspectives over the two years in our sample. While they had supported many shareholder proposals on climate change, gender pay/diversity, and political spending the prior year, the iShares ETFs in our ESGP sample voted against nearly all ESG proposals they faced in 2019.

In contrast, funds offered by specialized ESG fund creators voted fairly consistently in favor of shareholder proposals geared toward enhancing portfolio company ESG performance. For example, the Mid-Cap fund offered by Parnassus Investments, a firm that declares itself the “[l]argest pure play ESG fund company”¹⁰⁶ supported a proposal to include sustainability as a performance measure for senior executive compensation at Alphabet/Google. It likewise opposed management on ESG issues across both years and various holdings, voting in favor of proposals on gender pay equity, adoption of a board diversity policy, human rights, reporting on political spending, forced labor in the supply chain, and greenhouse gas emissions. The PAX MSCI EAFE ESG Leaders Index Fund, a passive product offered by ESG-specialist Pax World

¹⁰⁵ For analogous findings of mismatch across the Big Three’s voting records on stock buybacks and M&A, despite the claimed long-term orientation of these fund families, see Jan Fichtner & Eelke M. Heemskerk, *The New Permanent Universal Owners: Index Funds, (Im)patient Capital, and the Claim of Long-Termism* 17–30 (CorpNet, Working Paper, 2018), <https://ssrn.com/abstract=3321597> [<https://perma.cc/6J3X-NVRQ>]; see also Ross Kerber & Tim McLaughlin, *Biggest U.S. Index Funds Oppose Most Climate Proposals in Shareholder Votes*, REUTERS (Oct. 8, 2019, 6:05 AM), <https://www.reuters.com/article/us-usa-funds-index-climatechange/biggest-u-s-index-funds-oppose-most-climate-proposals-in-shareholder-votes-idUSKBN1WN105> [<https://perma.cc/ZM3L-UMQ2>] (reporting widespread voting against climate change proposals by large U.S. index funds).

¹⁰⁶ *Who We Are*, PARNASSUS INV., <https://www.parnassus.com/who-we-are> [<https://perma.cc/2MHQ-LYX3>].

Funds,¹⁰⁷ also consistently voted in favor of climate change and gender/diversity-focused proposals, as well as proposals to curb corporate political donations. It even opposed management proposals seeking European Union (EU)-required approval of political donations and expenditures many times over. Such proposals were extremely common in the two years we studied, and PAX funds posted among the very few votes ever to oppose them.

A simple specialist/generalist dichotomy alone does not explain all the variation we observe, however. Longstanding sustainable investing specialist Calvert¹⁰⁸ posted a mixed record. Calvert opposed management and voted in favor of several proposals for reports on gender pay and diversity across its holdings. Its Equity A fund supported greenhouse gas emission reporting and its US Large Cap Core Responsible Index Fund supported both the Alphabet/Google proposal to include sustainability as a performance measure in executive compensation and a proposal to establish a human rights board committee at Apple. But the Calvert US Large Cap Core Responsible Fund also voted against four climate change proposals.

At times, even the more consistent niche players split votes on ESG proposals addressing related topics. For example, Neuberger Berman's¹⁰⁹ Socially Responsible Fund voted in favor of all but one of a 2018 series of environmental proposals at Kroger. It supported proposals on renewable energy and deforestation and the supply chain but voted against a proposal to report on environmental impacts of the company's continued use of non-recyclable packaging.¹¹⁰ In 2019, the Endeavor Fund offered by specialist Parnassus split its votes on diversity issues; it supported

¹⁰⁷ See *About Pax*, PAX WORLD FUNDS, <https://paxworld.com/about> [<https://perma.cc/K8UG-4BPL>] (“[W]e offer a diverse lineup of investment strategies focused on the investment risks and opportunities associated with the transition to a more sustainable global economy.”).

¹⁰⁸ See CALVERT, <https://www.calvert.com> [<https://perma.cc/5Q4B-M6M6>] (“Calvert has been at the forefront of ESG investing for decades . . .”).

¹⁰⁹ The Neuberger Berman states that “[a]cross our investment platform, Neuberger Berman looks for opportunities to engage on ESG issues and trends, and to support clients to increase the impact of their investments.” *Who We Are*, NEUBERGER BERMAN, <https://www.nb.com/en/global/who-we-are> [<https://perma.cc/XV86-MCT9>].

¹¹⁰ Neuberger Berman Nationwide Variable Insurance Trust, Annual Report of Proxy Voting Record of Nationwide Variable Insurance Trust (Form N-PX) (Aug. 20, 2018). The Fund also supported an ESG reporting proposal, multiple lobbying reporting proposals, and gender pay gap risk reporting. See *id.*

several gender pay gap proposals but opposed two concerning board diversity.

Table 4 reports 2019 votes by funds in our three samples on three types of shareholder proposals that raise ESG issues.¹¹¹ Note that it tabulates fund votes only on climate change and sustainability (environmental), gender pay and diversity (social), and political spending (governance)¹¹² proposals.¹¹³ Of course, the sample funds confronted and voted on many other types of ESG proposals beyond the types Table 4 reports. Many faced votes on lobbying reporting, human rights issues, data privacy, changes to voting procedures, and independent board chair requirements. Representing the full range of proposals in a comprehensible format proved difficult, so we confine Table 4 to these three types of issues to provide an accessible snapshot of our results. Various other votes are highlighted in the discussion above and the analysis of potential explanations for the results that follows Table 4.

¹¹¹ Some of these votes may have been registered on proposals ultimately withdrawn by their proponents after negotiation with management to address the underlying issues. Regardless, they remain useful indicators of funds' ESG commitments.

¹¹² Views vary on whether other governance issues like independent board chair mandates or voting rule changes will impact financial performance. As our goal was to track a "G" issue that would align with investor perspectives on what is normatively good governance regardless of any related bottom line effect, we chose political spending. Proposals seeking disclosure of political spending seek greater transparency in pursuit of good governance, rather than performance changes in the targeted firm.

¹¹³ A similar table reporting the 2018 votes appears in Appendix III, *infra*. As noted there, when compiling the 2018 voting records, we searched only for proposals addressing climate change specifically. We were disappointed this search yielded relatively little information. To draw in a more representative "E" sample, for the 2019 data reported in Table 4, *infra*, we also include proposals more broadly addressing issues of sustainability.

Table 4: 2019 Voting Records

Sample Group	Fund	Climate Change/ Sustainability	Gender Pay/Diversity	Political Spending ¹¹⁴
Passive ESG	Vanguard FTSE Social Index	4 against	23 against	29 against
	Calvert US Large Cap Core Resp Index I	split 18-2 ¹¹⁵	split 23-5	24 for
	iShares MSCI KLD 400 Social ETF	split 2-11-4	split 1-29	split 1-21
	PowerShares Water Resources ETF ¹¹⁶	0 proposals	0 proposals	split 1-1
	PAX MSCI EAFE ESG Leaders Index Instl	8 for	0 proposals	0 proposals
	iShares MSCI USA ESG Select ETF	2 against	split 1-19	11 against
	Guggenheim S&P Global Water	0 proposals	0 proposals	1 for

¹¹⁴ Many of the funds in our sample voted on management proposals to authorize political spending, per European regulations. As these were not shareholder proposals, we do not report votes on them in Table 4. Other than the PAX opposition to these proposals, noted *supra* text accompanying note 107, these proposals were widely supported across all three fund categories.

¹¹⁵ Split votes are reported in the format for-against unless the fund abstained, in which case votes are reported in the format for-against-abstention.

¹¹⁶ Several funds in our sample faced no relevant votes on our selected environmental, social and governance issues during our sample period. Indeed, some faced no ESG-related proposals at all. Funds without reportable votes were primarily those dedicated to emerging market companies.

	iShares MSCI ACWI Low Carbon Target ETF	split 2-4	split 1-27	split 1-23
	Calvert Global Water A	3 for	1 for	4 for
	Guggenheim Solar ETF	0 proposals	0 proposals	0 proposals
	Green Century MSCI International Index Fund - Institution	0 proposals	0 proposals	0 proposals
	Praxis Growth Index Fund	split 7-1	split 20-5	19 for
	Praxis International Index	split 8-1	0 proposals	0 proposals
	Praxis Value Index	split 5-1	split 14-3	split 20-1
ESG	Pax Global Environmental Markets Instl	0 proposals	0 proposals	1 for
	Morgan Stanley Inst Global Opp I	3 against	split 5-4	0 proposals
	Calvert Emerging Markets Equity I	0 proposals	0 proposals	0 proposals
	RBC Emerging Markets Equity I	0 proposals	0 proposals	0 proposals

AB Sustainable Global Thematic A	2 for	split 1-3	1 for
Amana Income Investor	2 against	1 against	3 against
Domini Impact International Equity Inv	0 proposals	0 proposals	0 proposals
Eventide Gilead N	0 proposals	2 for	1 for
Neuberger Berman Socially Rspns Inv	1 for	split 3-3	1 for
Parnassus Mid-Cap	0 proposals	0 proposals	2 for
Hartford Schroders Emerging Mkts Eq I	0 proposals	0 proposals	0 proposals
Amana Growth Investor	1 against	split 3-5 ¹¹⁷	2 against
Calvert Equity A	1 for	split 2-1	3 for
TIAA-CREF Social Choice Eq Instl	2 for	split 9-5-1	split 14-6

¹¹⁷ This tally includes the apparent vote opposing a gender pay gap proposal at Adobe, discussed *supra* note 104 and accompanying text.

	Parnassus Endeavor Investor	3 for	split 4-2	0 proposals
	JPMorgan Emerging Markets Equity A	0 proposals	0 proposals	0 proposals
	Parnassus Core Equity Investor	3 for	split 4-2	0 proposals
Non-ESG	Morgan Stanley Global Core Portfolio	2 against	split 3-3	split 2-1
	iShares Core S&P 500 ETF	split 1-12	split 1-29	split 1-37
	Neuberger Berman Large Cap Value Fund	2 against	5 against	split 4-2
	TIAA-CREF Growth & Income Fund	split 2-2	split 3-9	split 5-2
	Vanguard 500 S&P Index	6 against	10 against	21 against
	Vanguard Equity Income Fund Investor Shares	split 1-3	9 against	5 against
	JP Morgan Emerging Economies	0 proposals	0 proposals	0 proposals

There are numerous explanations for why ESG funds in our sample do not uniformly support shareholder proposals aimed to enhance portfolio company ESG performance. Importantly, not every fund in our sample adopts an ESG orientation per se. For example, we included the Amana funds in our sample based on their AUM, returns, and Morningstar sustainability ratings, but Amana's philosophy is more aptly

described as values-aligned and faith-based. It explains that “[t]he Amana Funds limit the securities they purchase to those consistent with Islamic principles.”¹¹⁸ The voting record of Praxis Growth Index Fund, whose sponsor “embrace[s] a wide range of social concerns our Christian faith calls us to consider—as well as traditional, prudent, financial considerations,”¹¹⁹ too, is mixed on proposals raising ESG issues. These faith-based models need not overlap with environmental sustainability concerns and may offer a different vision of social issues to investors, with which their voting records may well align.

Even for funds with a secular ESG goal, these issues still entail challenging and contested questions about what course of action will achieve ESG gains. For example, many funds in our samples voted on proposals to adopt or pursue reporting on compliance with the Holy Land Principles in 2018. Depending on one’s views about the Holy Land Principles, a yes-vote might be seen to further social considerations favoring anti-discrimination efforts or to undermine social considerations by inflaming sectarian conflict. In addition, ESG gains can be in conflict with each other and will not always correlate with financial return. Fund management dedicated to integrating ESG factors into their investment strategies might reasonably dispute the value of individual proposals that on their face appear geared toward enhancing ESG performance.

Even if the underlying issue a proposal raises is clearly one intended to further ESG performance, not all such shareholder proposals will advocate good ideas and our sample does not attempt to discern the quality of shareholder proposals. SEC rules impose numerous limitations on who can make shareholder proposals and their content,¹²⁰ and issuers can seek guidance from the SEC staff on whether submitted proposals can

¹¹⁸ SATURNA CAP., <https://www.saturna.com/amana> [<https://perma.cc/CEX6-CY4C>].

¹¹⁹ PRAXIS MUTUAL FUNDS, <https://www.praxismutualfunds.com> [<https://perma.cc/9CAM-JU7E>].

¹²⁰ See 17 C.F.R. § 240.14a-8 (2019) (limiting proposal access to shareholders holding “at least \$2,000 in market value, or 1%, of the company’s securities entitled to be voted on the proposal at the meeting for at least one year” and limiting each such shareholder to one proposal per meeting and the length of the proposal to under five hundred words).

be (relatively) safely excluded from management's proxy materials.¹²¹ This process will often weed out proposals that raise improper issues or sow confusion, but a proposal appropriately included on management's proxy can still address an ESG issue in a way that a particular ESG fund considers unnecessary, counterproductive, or unwise.

Consider the Kroger proposal on non-recyclable packaging that was opposed by Neuberger Berman's Socially Responsible Fund. The company faced prior shareholder proposals on this same issue and had issued a plan in 2016 to address environmental issues in its packaging by 2020.¹²² A fund with strong commitments to ESG might view the company's efforts as sufficient and the proposed reporting obligation to be a potential distraction. Indeed, although the shareholder proposal failed, Kroger announced shortly thereafter that it planned to phase out plastic bags entirely by 2025.¹²³

Another good example is the conflicting votes cast by the Morgan Stanley Global Opportunity Portfolio Fund on two proposals addressing government use of facial recognition technology at Amazon in 2019. The Fund voted against a shareholder proposal to prohibit sales of facial recognition technology to government agencies but abstained on a proposal requesting a report on the impact of government use of such technologies. (Management opposed both measures.) Like several others, this fund also consistently voted yes on proposals on the gender pay gap but often voted against board diversity proposals. A reasonable ESG-committed investor may well view government use of facial recognition as concerning, but not be convinced of the value of an outright ban.

¹²¹ See *id.* § 240.14a-8(i)-(j) (describing the reasons for which companies may exclude proposals, and the process they must follow to do so, including a requirement that companies planning to exclude proposals notify the Commission of their plans and reasoning).

¹²² See THE KROGER CO., NOTICE OF 2017 ANNUAL MEETING OF SHAREHOLDERS: 2017 PROXY STATEMENT AND 2016 ANNUAL REPORT 53 (2017).

¹²³ See Heather Haddon, *Kroger to Ditch Plastic Bags by 2025*, WALL ST. J. (Aug. 23, 2018, 6:30 AM), <https://www.wsj.com/articles/kroger-to-ditch-plastic-bags-by-2025-1535020200> [perma.cc/PG8W-Y4TM]. Kroger's packaging policy in place at the time of the vote stated:

By 2020, Kroger will optimize packaging in Our Brands by following a balanced, multi-pronged approach that considers design attributes including but not limited to food safety, shelf life, availability, quality, material type and source, function, recyclability and cost. Through the design optimization process, Kroger will strive to increase the recyclability of Our Brands manufactured plastic packaging.

The Kroger Co., Schedule 14A Proxy Statement (Form DEF 14A) (May 15, 2018).

Similarly, such an investor might oppose gender pay disparities but question the value of board diversity requirements.

Remember, too, the companies in ESG fund portfolios are often selected for inclusion because of their comparatively high ESG performance. This selection bias may lead ESG fund managers to prefer the ESG plans and prerogatives of portfolio company management to those advocated by shareholder proposals. It also likely explains the relative paucity of climate change proposals we unearthed in our 2018 samples. As noted in Appendix III, when compiling the 2018 voting records, we searched only for proposals addressing climate change specifically. We were disappointed this search yielded relatively few proposals. To draw in a more representative “E” sample for the 2019 data reported in Table 4, we also include proposals more broadly addressing issues of sustainability, but there were still fewer of these proposals than in our other categories.

Research has also shown that fund families frequently choose to vote all shares owned by their constituent funds consistently, rather than voting holdings on a fund-by-fund basis to accord with investor preferences particular to individual funds.¹²⁴ Where deviation from centralized voting decisions occurs, it is primarily to enable divergent votes by active funds. Cost pressure and other efficiency concerns and the desire to maximize a fund family’s influence with portfolio companies and in the market may motivate this kind of batch voting. But it will often lead to undermining investor expectations of ESG funds.¹²⁵ ESG proposals can be expensive to implement. A non-specialist fund family

¹²⁴ See Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 493, 517 (2018) (reporting that “[t]he Big Three closely adhere to their voting guidelines and are thus able to achieve lock-step consistency in voting across funds” in an article arguing that passive funds should not vote their shares); Ann M. Lipton, *Family Loyalty: Mutual Fund Voting and Fiduciary Obligation*, 19 TRANSACTIONS: TENN. J. BUS. L. 175, 187–89 (2017) (criticizing the practice of fund families voting all funds “as a block” and canvassing potential reforms); Sean J. Griffith & Dorothy S. Lund, *Conflicted Mutual Fund Voting in Corporate Law*, 99 B.U. L. REV. 1151 (2019) (pointing out this practice in work and setting out a taxonomy of conflicts it creates); Griffith, *supra* note 34, at 12–16 (describing this common practice).

¹²⁵ As the literature in *supra* note 124 articulated, centralized voting by fund families will virtually always undermine the preferences of some of their investors. See, e.g., Lipton, *supra* note 124, at 189–92. Commentators have offered a range of potential reforms to address the issue. See e.g., Griffith, *supra* note 34, at 33–48 (arguing both for decentralization of mutual fund voting and to remove the default practice of mutual fund voting for ESG shareholder proposals). See generally Lipton, *supra* note 124, at 187–89 (canvassing potential reforms).

overall may view the potential financial return on ESG gains as insufficient to justify these extra expenses in order to achieve ESG gains, even if managers and investors of its ESG funds would differ.

Centralized voting practices like these could explain the many surprising Vanguard FTSE Social Index votes. No-votes by this passive ESG fund are matched by nearly identical votes opposing environmental, gender/diversity, and political spending proposals by the two Vanguard funds in our non-ESG sample. Still, centralized voting is clearly not a universal practice. BlackRock's iShares' ESG funds votes supporting ESG proposals in 2018 diverged notably from the record of the non-ESG iShares Core S&P ETF. For example, its MSCI KLD 400 Social ETF fund voted against management and in favor of proposals to report on the gender pay gap, lobbying payments, board diversity, and global content management at Alphabet that year, resolutions its Core S&P 500 ETF opposed. In 2019, however, iShares' ESG and non-ESG voting patterns look much more similar.

Funds may also be using engagement strategies other than shareholder proposal votes to pursue their ESG goals. Particularly for large players like the passive Big Three,¹²⁶ interventions at the board or executive level may be viewed by fund managers as more important or effective ways to generate improved ESG performance at portfolio companies. Although voluntary engagement or stewardship reporting has become more common, the precise contours of this kind of influence will remain opaque to investors and other stakeholders.

The most worrisome explanation, of course, is that some ESG fund sponsors and managers are not as committed to the pursuit of ESG performance as their branding suggests. Funds meet their fiduciary and securities law obligations by establishing a share-voting policy consistent with their clients' best interests, disclosing the policy to their clients, and reporting their votes annually to the SEC.¹²⁷ Recent SEC Guidance

¹²⁶ Often referred to as the "Big Three," BlackRock, Vanguard, and State Street now dominate U.S. passive investing, managing over ninety percent of AUM. See Fichtner et al., *supra* note 7, at 303–04.

¹²⁷ Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies Release Nos. 8188, 25922, 47304, 33-8188, 34-47304, IC-25922, 2003 WL 215451 (Jan. 31, 2003); Proxy Voting by Investment Advisors Release Nos. 2106, IA-2106, 79 S.E.C. Docket 1673 (Jan. 31, 2003) (announcing the disclosure regulation and discussing mutual fund voting more generally); see also Lipton, *supra* note 124, at 183–87 (discussing the history and

reminds funds that compliance with their obligations in voting client shares turns on serving the client's best interest and warns that funds may not woodenly rely on the recommendations of proxy advisors.¹²⁸ SEC Guidance recommends a fund "consider how its fiduciary duty and its [securities law] obligations . . . apply when it has multiple clients" such as "funds, other pooled investment vehicles, and individual investors, with differing investment objectives and strategies," but does not require fund families to establish and follow fund-by-fund voting policies.¹²⁹ Funds can apply their client-best-interest policy based on their analysis of voting questions or carefully vet and regularly monitor proxy advisors to whom they delegate such tasks. Either way, no specific voting content is required.

A faithless ESG fund sponsor or manager incurs little regulatory risk by opposing an ESG-enhancing shareholder proposal, so long as doing so is justified by their client-best-interest policy. Risks from detection by investors themselves are also minimal. Investors expecting their ESG fund managers to assiduously pursue ESG performance—whether because they believe this performance will improve financial returns or because they care about these factors for non-financial reasons—can review these votes only if they are extraordinarily diligent.¹³⁰ Few are likely to do so, though, especially across the long list of portfolio companies contained in a fund and over time. Even for those investors willing to engage in this effort, their only recourse in the event of a

development of these requirements); Griffith, *supra* note 34, at 13–16 (relating the history and noting that while SEC rules—unlike ERISA regulation—do not issue a directive to vote every share, it has become "the standard practice of mutual funds").

¹²⁸ Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, SEC Guidance Release Nos. IA-5325, IC-33605, 2019 WL 4303125, at *15–16 (Aug. 21, 2019).

¹²⁹ *Id.* at *13–14. Anticipated additional SEC regulations of proxy advisors will likely require them to offer issuers two opportunities for advance review of proxy voting materials they plan to circulate and to increase the thresholds for defeated proposals to be resubmitted to shareholders at subsequent meetings. See Patrick Temple-West & Kadhim Shubber, *US SEC to Propose Regulations for Proxy Advisers*, FIN. TIMES (Oct. 25, 2019), <https://www.ft.com/content/778602a8-f6b1-11e9-a79c-bc9acae3b654> [<https://perma.cc/B35U-QT44>].

¹³⁰ See Scott Hirst, *Social Responsibility Resolutions*, 43 J. CORP. L. 217, 235–36 (2018) (describing the voluminous nature of this reporting and summarizing the problem as "there is currently no way for mutual fund investors to gain a comprehensive view of the voting of the mutual funds in which they invest or may wish to invest"). Our own efforts confirm the burden and barriers associated with attempts to do so.

shareholder proposal vote with which they disagree will be to sell their holdings in the fund.

Mismatch of ESG investor expectations and ESG fund practices is a particular concern in the passive context. In an active fund, fund managers use portfolio composition (both buy and sell) to voice ESG preferences even if they do not do so by voting on shareholder proposals.¹³¹ Passive funds have far less ability to exercise voice through exit, amplifying the importance of vote as ESG voice and signal. Our sample provides some cause for optimism on this score, as it does not reveal notable differences in voting activity between active and passive funds. That said, a finding that passive ESG funds voted more frequently or consistently for ESG proposals than their active counterparts would have been more encouraging. Of course, our sample is illustrative rather than comprehensive, and its fundamental finding is one of variation. Whether actively or passively managed, the fact that a fund brands itself as ESG gives investors no assurance of how it will vote its shares.

5. Unique Passive Risks: Tracking Errors

Tracking error, the final fund attribute our study reviews, is unique to index investing. Passive funds constructed against an index necessarily fall short of replicating that index exactly. Tracking error measures this divergence between a fund's performance and the performance of the index that the fund is tracking.¹³² Tracking error results from various causes, including transaction and rebalancing costs, uninvested cash (drag), differing dividend reinvestment practices, securities lending, omitted dividend taxes from the index, sampling errors or divergent techniques, variable swap spreads, variable total expense ratios, fund operational risks, and choosing the right benchmark index.¹³³ Average

¹³¹ The authors thank Sean Griffith for this insight.

¹³² See e.g., iShares MSCI KLD 400 Social ETF, *supra* note 61. Tracking error “measures the quality of index replication, i.e. how well a fund manager replicates the performance of a specific index.” BEN JOHNSON ET AL., MORNINGSTAR, ON THE RIGHT TRACK: MEASURING TRACKING EFFICIENCY IN ETFs 5 (2013), https://media.morningstar.com/uk/MEDIA/Research_Paper/Morningstar_Report_Measuring_Tracking_Efficiency_in ETFs_February_2013.pdf [<https://perma.cc/BT84-T5R3>] [hereinafter MS Tracking Report].

¹³³ See MS Tracking Report, *supra* note 132, at 5–8.

tracking error¹³⁴ for our ESGP sample is 1.67, whereas the average ETF tracking error is 0.59.¹³⁵

All indexed funds face risks associated with indexing itself, including errors in data, computation, and indexing methodology. iShares funds disclose the following standard language:

Errors in index data, index computations or the construction of the Underlying Index in accordance with its methodology may occur from time to time and may not be identified and corrected by the Index Provider for a period of time or at all, which may have an adverse impact on the Fund and its shareholders.¹³⁶

While these errors exist with standard index funds, the risks are likely amplified with indexed ESG funds, especially compared to a standard S&P 500 index fund.¹³⁷ ESG index methodology is opaque as to the criteria, weights, and balance. There is also greater index asset valuation variation with ESG indices, driven by a particular index's ESG preference compared with standard financial performance measures in traditional indices.

Table 5 reports tracking errors in our sample of ESGP funds. Obtaining tracking errors was a challenge and thus the following is illustrative of the range of tracking errors, rather than a strict comparison of absolutes. Further, calculating tracking errors, in general, is a process itself that can be rife with errors given the volume of data, misaligned data, and calculation errors.¹³⁸ Please see the associated footnotes for additional information on the figures presented.¹³⁹

¹³⁴ See *infra* note 139. The above reported ranges were averaged for a single tracking error and that estimated annualized errors are used in the calculations. Average excludes funds for which there was no reported tracking error.

¹³⁵ See Lara Crigger, *The Top 7 Socially Responsible ETFs*, ETF.COM (Mar. 1, 2017), <https://www.etf.com/publications/etfr/top-7-socially-responsible-etfs> [<https://perma.cc/VZW4-62E8>].

¹³⁶ iShares MSCI USA ESG Select ETF, *supra* note 60.

¹³⁷ See MORNINGSTAR, *PASSIVE SUSTAINABLE FUNDS*, *supra* note 35, at 22–23.

¹³⁸ See MS Tracking Report, *supra* note 132, at 10.

¹³⁹ Challenges to obtaining tracking errors included different years reporting the tracking errors (2017–2018) and different time periods of reported tracking errors ranging from monthly (annualized to create estimated annual) errors to one-, three- and five-year errors. Unlike other information reported in this Article, we were not able to obtain (or verify) tracking errors from SEC

Table 5: 2018 Tracking Errors

Fund	Tracking Error
Vanguard FTSE Social Index Inv.	1
Calvert US Large Cap Core Rspn Idx I	1.41-1.69 ¹⁴⁰
iShares MSCI KLD 400 Social ETF	1.65
PowerShares Water Resources ETF	1.2 ¹⁴¹
PAX MSCI EAFE ESG Leaders Index Instl	2.49-2.57 ¹⁴²
iShares MSCI USA ESG Select ETF	-
Guggenheim S&P Global Water ETF	2.02 ¹⁴³
iShares MSCI ACWI Low Carbon Target ETF	-
Calvert Global Water A	2.77 ¹⁴⁴
Guggenheim Solar ETF	2.05 ¹⁴⁵
Green Century MSCI International Index Fund - Institution	-
Praxis Growth Index Fund A	0.67
Praxis International Index A	-
Praxis Value Index A	1.26

High tracking error does not necessarily mean poor relative financial performance and vice versa with low tracking errors.¹⁴⁶ Yet, “[t]here is

filings directly, but rather we relied exclusively on third party presentations of the data, often from state retirement plan documents, internal fund reports, and other sources.

¹⁴⁰ Variation reflects a three- and five-year reported tracking error.

¹⁴¹ Estimated annualized tracking error determined from reported monthly tracking error of 0.12.

¹⁴² Three-year reported tracking error; variation depends upon class.

¹⁴³ Estimated annualized tracking error determined from reported monthly tracking error of 0.34.

¹⁴⁴ Five-year reported tracking error.

¹⁴⁵ Estimated annualized tracking error determined from reported monthly tracking error of 0.35.

¹⁴⁶ See MS Tracking Report, *supra* note 132, at 3. Further, for the ETF funds, tracking error is an incomplete measure; tracking error alone does not capture “the actual magnitude” of under or over performance. *Id.* at 9. Tracking difference is “the annualised difference between a fund’s actual return and its benchmark return over a specific period of time.” *Id.* Low tracking difference signals that the ETF is matching its stated index. *Id.*

usually a trade-off between ESG performance and tracking error.”¹⁴⁷ Within our limited review of ESGP Funds, ten funds disclosed specific investment risks associated with indexed investing and tracking errors.¹⁴⁸ The risk disclosures varied in content and complexity from generic disclosures¹⁴⁹ to a comprehensive mini treatise on tracking errors at 408 words provided by a Guggenheim fund, S&P Global Water ETF, a sector-focused index fund.¹⁵⁰

Examples of disclosed ESG tracking error include asset, pricing, transaction, and objective differences between the index and fund. For example, a fund may hold different assets from the underlying index because of a representative sampling approach, limited availability of the security in the amount needed to match the index, uninvested cash for liquidity, or even tax motivations.¹⁵¹ Transaction costs and timing are also commonly disclosed as additional expenses which contribute to tracking error.¹⁵² Such costs that negatively affect index tracking may include the costs associated with rebalancing a portfolio to match the index and account for size or additional brokerage fees, and expense ratios.¹⁵³ Further, pricing differences between fair value and end of the day net asset value (NAV) may also drive different returns between the index (fair value) and the fund (NAV).¹⁵⁴ The use of stewardship and investment

¹⁴⁷ MORNINGSTAR, PASSIVE SUSTAINABLE FUNDS, *supra* note 35, at 21; *see also id.* at 22–23 (explaining that as funds seek greater impact, tracking error rises compared to the broader market).

¹⁴⁸ Notes on file with author.

¹⁴⁹ “Asset Class Risk—The securities in the Fund’s portfolio may underperform the returns of other securities or indices that track other industries, markets, asset classes or sectors.” Guggenheim S&P Glob. Water Index ETF, Summary Prospectus (Form 497K) (Dec. 29, 2017).

¹⁵⁰ *Id.*

¹⁵¹ *See, e.g.*, iShares MSCI KLD 400 Social ETF, *supra* note 61 (describing asset differences); *see also* Guggenheim Solar ETF, Summary Prospectus (Form 497K) (Dec. 29, 2017) (providing a comprehensive discussion of tracking errors).

¹⁵² “Tracking error also may result because the Fund incurs fees and expenses, while the Underlying Index does not.” iShares MSCI ACWI Low Carbon Target ETF, *supra* note 76.

¹⁵³ “Factors such as Fund expenses, imperfect correlation between the Fund’s investments and the Index, rounding of share prices, changes to the composition of the Index, regulatory policies, high portfolio turnover rate and the use of leverage all contribute to tracking error.” Calvert US Large-Cap Core Responsible Index Fund, Summary Prospectus (Form 497K) (June 15, 2018).

¹⁵⁴

screens to alter the indexed portfolio may also contribute to performance deviations.¹⁵⁵ Finally, some funds may deviate from an index in a hybrid passive/active strategy and go outside of an index to bolster returns (financial, ESG, or both) through active investment.¹⁵⁶

Tracking error, a problem with all indexed investments, may be amplified with ESGP Funds given the opacity of ESG indices, variation in index attributes, and market size of ESG companies.¹⁵⁷ Investors bear the actual costs of high tracking errors, plus the added burden of evaluating tracking error risks without transparency.

6. Summary

Reviewing the investment strategy disclosures, fees, portfolio holdings, and voting practices of our sample funds reinforces concerns that ESG investing, and passive ESG in particular, may have difficulty delivering on its tremendous promise. The price of ESG investment products, while decreasing in response to competition, remains high. Although evidence is mounting that better financial returns are associated with considering ESG factors in making investments, high fees can quickly eliminate marginal improvements in financial performance. ESG investing in practice also includes investment products with a very broad range of investment strategies, with often little detail on the contours of a given fund's ESG practices and commitments. Even vague definitions can suffice to meet funds' securities law disclosure obligations

To the extent the Fund calculates its NAV based on fair value prices and the value of the Index is based on the securities' closing prices (i.e., the value of the Index is not based on fair value prices), the Fund's ability to track the Index may be adversely affected.

Guggenheim S&P Glob. Water Index ETF, *supra* note 149.

¹⁵⁵ "Application of Stewardship Investing screens may contribute to tracking error." Praxis Growth Index Fund A, Summary Prospectus (Form 497K) (April 30, 2018).

¹⁵⁶ See *Passive and Enhanced Passive Strategies*, PRI, <https://www.unpri.org/listed-equity/esg-integration-in-passive-and-enhanced-passive-strategies/15.article> [<https://perma.cc/ERK5-LHLG>] (describing "enhanced passive" ESG investing as "using the index and its constituent weights as the core of the portfolio, and engaging in restricted active strategies, including divesting certain securities, adjusting the weights of constituents and trading derivatives").

¹⁵⁷ For example, smaller capitalization companies introduce higher potential transaction costs associated with market depth and contribute to price volatility when a fund must buy or sell shares to maintain index exposure. Anne M. Tucker & Holly van den Toorn, *Will Swing Pricing Save Sedentary Shareholders?*, 18 COLUM. BUS. L. REV. 130, 140 (2018).

but leave investors without a clear understanding of how ESG investing will be practiced by a particular fund and make it difficult to compare across offerings.

Investigating holdings and voting patterns slightly clarifies this murky picture, with specialist funds and fund providers emerging as more often offering distinct—though not necessarily superior—ESG investment products. Funds targeting particular industries or sustainability themes offer highly tailored, specialized portfolios that do not overlap with other funds and do not focus on mainstream investments in household name companies shared by both more general ESG and non-ESG funds. In contrast, broad-based ESG and non-ESG funds appear to invest in largely similar portfolios. Specialist fund providers often, though certainly not always, appear to use voting on shareholder proposals to bolster their ESG goals, and generalist players post an eclectic mix of results. Perhaps ironically, the consistent finding of our study is one of variation. The funds diverge so widely on our various metrics that it will be extremely difficult for an investor to know what she is getting when she invests in an ESG fund.

Passive ESG largely replicates these general concerns, but also introduces new ones. ESG investors who choose index funds will generally save on expense ratios when compared to active ESG funds. Still, fees for ESG index funds are higher than industry averages, raising the specter of cost overwhelming any additional gains. The problems with vague disclosures about ESG investment strategies, portfolio holdings that align with non-ESG funds, and wide-ranging voting patterns appear in active and passive ESG funds alike. The confounding element of tracking error, however, is unique to the passive context. Some level of tracking error is an unavoidable feature of passive strategies; it represents deviation from the underlying index and need not undermine the financial performance of a fund. In ESG Index funds, however, investors will find it difficult to achieve both the low tracking error typical of broadly diversified funds and strong ESG performance.

The passive ESG trend also compounds the already high level of opacity in ESG investing. Tracking an index adds another—very private—layer to a fund's ESG strategy. Index purveyors argue they are offering fund providers the deep expertise needed to evaluate ESG factors, topics on which investment fund experience is shallow. But proprietary indices designed by private firms like MSCI make it ever more difficult

for investors to understand and assess the particular version of ESG a fund pursues.

Beyond concerns about delivering on investors' expectations from ESG funds is skepticism that funds can deliver on improved portfolio firm behavior, especially around environmental and social practices.¹⁵⁸ When ESG can be any combination of the initiatives—environmental, social, or governance—we suspect that governance attributes are often pursued over environmental or social attributes because funds and index providers alike prefer easily tracked ESG practices that are linked to firm profits and applicable across a range of firms.

The ESG investment landscape, facilitated by an unregulated ESG market, is heterogeneous and opaque. This, combined with investor heterogeneity—issues we further explore in the next two Sections—make the task of matching high ESG-committed investors and investment products arduous.

II. DEMAND

Despite the significant ESG variation and opacity that the literature describes¹⁵⁹ and our data confirm, a range of investors are flocking to active and passive ESG. Matching ESG-motivated investors to the right fund is a multifaceted problem. Investor heterogeneity and intermediated transactions complicate a potential ESG match. This Part will explore the diverse set of investors driving ESG asset growth and factors shaping their choice of ESG investment strategy.

Investor demand for ESG products is far from monolithic. Individual investors have a range of ESG commitments and fall along a spectrum of “willingness to pay” for the ESG they desire.¹⁶⁰ As a group, individual investors also have different preferences and requirements than institutional investors, even though institutions often serve as intermediaries and aggregators for individual investors' portfolios. There are also many different types of institutional investors, whose interest in ESG investing differs by client base, regulatory regime, geography, and

¹⁵⁸ Brest et al., *supra* note 17, at 13 (expressing deep skepticism that investment in public markets can ever change portfolio company behavior).

¹⁵⁹ *Id.* at 1; Barber et al., *supra* note 17, at 2; Gezcy et al., *supra* note 17, at 23.

¹⁶⁰ Barber et al., *supra* note 17, at 29.

other factors. These variations in investor demand for ESG investment products partly explain the variation in ESG product offerings, as investors bring their own preferences to bear on market developments and their appetites and attitudes influence product development. Perhaps these various segments of the ESG investment market are indeed getting matched with the ESG they are willing to pay for, but perhaps not.

Individual investor interest in ESG investing is significant and growing.¹⁶¹ In part, this growth can be explained by the simple desire to align one's investments with one's values, in the same way individuals want to feel the warm glow of other products and services they consume.¹⁶² The shopper who favors Fair Trade coffee to channel her grocery expenditures to small growers or selects a pink yogurt cup to support breast cancer research may likewise favor ESG investing over a standard approach. It is worth noting that our hypothetical "she" is indeed more likely to be female, and younger than the average investor. Interest in sustainable and ESG investing appears concentrated in women and millennials.¹⁶³ While fifty-three percent of all respondents in a 2018 survey of high net worth individuals stated that "ESG trade record" was important in making investment decisions, sixty-four percent of women and eighty-seven percent of millennials did so.¹⁶⁴ More granular research

¹⁶¹ See MORNINGSTAR, *supra* note 3, at 1 (collecting studies indicating growing individual investor interest in sustainable investing).

¹⁶² See Usha Rodrigues, *Entity and Identity*, 60 EMORY L.J. 1257, 1259–1260 (2011) (describing the economic concept of warm glow as "the utility one derives from giving" but noting that companies engaging in corporate social responsibility now frequently sell it).

¹⁶³ See, e.g., Carol J. Clouse, *The New Allure of Sustainable Investing*, BARRON'S (June 9, 2018), <https://www.barrons.com/articles/the-new-allure-of-sustainable-investing-1528502401> [<https://perma.cc/3DQS-G4SL>] ("While much of the financial industry's focus on ESG skews toward the young folks, surveys indicate that women's interest in this approach is nearly as high as millennials'"); John Waggoner, *Millennials, Women Drive Assets to ESG Strategies*, INV. NEWS (Nov. 7, 2017), <https://www.investmentnews.com/article/20171107/FREE/171109942/millennials-women-drive-assets-to-esg-strategies> [<https://perma.cc/37NA-8A4M>] (reporting panelists' comments at an industry event that "[t]wo groups of people—women and Millennials—are responsible for the doubling of ESG assets to \$8.1 trillion worldwide since 2014"); Beth Brearley, *ESG and Women Investors: A Meeting of Movements*, INV. WEEK (Oct. 10, 2018), <https://www.investmentweek.co.uk/investment-week/opinion/3063826/a-meeting-of-movements-as-industry-joins-forces> [<https://perma.cc/Y4ZJ-E2AP>] (similar).

¹⁶⁴ 2018 U.S. Trust Insights on Wealth and Worth Survey, BANK AM. (June 2018), https://newsroom.bankofamerica.com/system/files/2018_US_Trust_Insights_on_Wealth_and_Worth_Overview.pdf [<https://perma.cc/2VSZ-FCC8>]; see also MORGAN STANLEY, SUSTAINABLE

on the level of ESG impact these more motivated investors are seeking, and their willingness to pay for it, requires further study.

No matter the demographic, however, individual investor preferences are often translated through an array of investment intermediaries (some of which are themselves institutional investors, or agents of institutional investors). Brokers, investment advisors, family wealth officers, and pension and retirement plan fiduciaries all channel individuals' money into investment products on behalf of their clients and beneficiaries. These intermediaries' interest in ESG strategies varies considerably depending on the type of investor they represent and the regulatory regime they confront. On the one hand, financial advisors' appetite for ESG offerings is significant and growing. A 2018 study of these intermediaries, who counsel individual savers about their investment choices, found twenty-six percent currently use or recommend ESG funds to clients and twenty percent "expect to increase [their] recommendation" of such funds "over the next 12 months."¹⁶⁵ On the other hand, pension and retirement plan fiduciaries' appetite for ESG investments is mixed.¹⁶⁶

The staggering growth of ESG investing over the last decade is also fueled by uptake from institutional investors.¹⁶⁷ A 2017 State Street global study of institutional investors found eighty percent use ESG strategies as part of their portfolios, representing a wide range of levels of adoption.¹⁶⁸

SIGNALS: NEW DATA FROM THE INDIVIDUAL INVESTOR (2017), https://www.morganstanley.com/pub/content/dam/msdotcom/ideas/sustainable-signals/pdf/Sustainable_Signals_Whitepaper.pdf [<https://perma.cc/P55M-3PLG>](reporting seventy-five percent of investors are interested in sustainable investing, and eighty-six percent of millennials are also interested).

¹⁶⁵ FIN. PLANNING ASS'N, 2018 TRENDS IN INVESTING SURVEY 2, 4 (2018), <https://www.onefpa.org/business-success/Documents/2018%20Trends%20in%20Investing%20Survey%20Report%20-%20FIN.pdf> [<https://perma.cc/V7TC-PG54>].

¹⁶⁶ See *infra* text accompanying notes 175–191.

¹⁶⁷ See MORNINGSTAR, *supra* note 3, at 1 (citing GLOB. SUSTAINABLE INV. ALL., 2016 GLOBAL SUSTAINABLE INVESTMENT REVIEW (2017)).

¹⁶⁸ See STATE ST. GLOB. ADVISORS, ESG INSTITUTIONAL INVESTOR SURVEY: PERFORMING FOR THE FUTURE 6–7 (2017), <https://www.ssga.com/investment-topics/environmental-social-governance/2018/04/esg-institutional-investor-survey.pdf> [<https://perma.cc/JP3G-LVJD>]. A Morgan Stanley survey of "public and corporate pensions, endowments, foundations, sovereign wealth entities, insurance companies and other large asset owners worldwide" returned similar results, with "84% of the asset owners" surveyed at least "actively considering" integrating ESG criteria into their investment process, with nearly half already integrating it across all their investment decisions. *Morgan Stanley Survey Finds Sustainable Investing Momentum High Among*

Results among U.S. institutional investors were strong as well, with “27% of investors incorporat[ing] ESG factors in at least half of their investments.”¹⁶⁹ Many of these institutional investors are now committed to the Principles for Responsible Investment,¹⁷⁰ which now boasts over 2,300 signatories managing over \$86 trillion in assets.¹⁷¹ Signatories to this project, supported by the United Nations and developed by a group of institutional investors,¹⁷² pledge to “incorporate ESG issues into investment analysis and decision-making processes” and to engage in active ownership around these issues.¹⁷³ Every type of institutional investor can be found amongst the PRI’s signatories: sovereign wealth funds, public and private pension funds, insurance companies, foundations and other endowments, and, of course, investment companies. These distinct types of institutional investors participate in ESG investing at quite different rates, perhaps indicating a range of willingness on their part—and the part of the investors they often represent—to bear ESG investing’s cost.

A. *Pioneers and Major Players*

Sovereign wealth funds and U.S. and worldwide public pension funds were early adopters of ESG investing practices, and today represent the largest investors in this growing market.¹⁷⁴ The Norwegian

Asset Owners, MORGAN STANLEY (June 18, 2018), <https://www.morganstanley.com/press-releases/morgan-stanley-survey-finds-sustainable-investing-momentum-high> [https://perma.cc/TL4M-KE49].

¹⁶⁹ See STATE ST. GLOB. ADVISORS, *supra* note 168, at 7.

¹⁷⁰ See PRI, PRINCIPLES FOR RESPONSIBLE INVESTMENT: ANNUAL REPORT 2018, at 25 (2018), https://d8g8t13e9vf2o.cloudfront.net/Uploads/g/f/c/priannualreport_605237.pdf [https://perma.cc/3JFF-6K GK] (identifying the United States as “PRI’s largest market, with more than 345 signatories managing US\$36 trillion”); MORNINGSTAR, *supra* note 3, at 27 (reporting that “[v]irtually all of the largest fund companies in the U.S. are now signatories”).

¹⁷¹ See *About the PRI*, PRI, <https://www.unpri.org/pri/about-the-pri> [https://perma.cc/N4QA-JQ39] (click on “Data and methodology available here, updated annually”).

¹⁷² See *About the PRI*, *supra* note 171.

¹⁷³ See *What Are the Principles for Responsible Investment?*, PRI, <https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment> [https://perma.cc/BH7E-5364].

¹⁷⁴ See Tom Arnold, *Socially Responsible Investing Catching on Among Sovereign Funds: Study*, REUTERS (Sept. 30, 2019, 8:50 AM), <https://www.reuters.com/article/us-swf-markets-environment/socially-responsible-investing-catching-on-among-sovereign-funds-study>

Government Pension Fund Global is the world's largest sovereign wealth fund and a source of its public pension funding.¹⁷⁵ It has been a pioneer in this area, first focusing on sustainable investment in 2001.¹⁷⁶ The Norwegian fund continued to expand its ESG focus over the ensuing years, in response to government mandates.¹⁷⁷ Today it asserts that “[g]ood financial return over time is deemed to be contingent on a sustainable development in economic, environmental and social terms, and on well-functioning, efficient and legitimate financial markets.”¹⁷⁸ Toward this end, it both excludes firms from its portfolio based on environmental and social goals, and practices engagement on these issues with the firms in which it invests.¹⁷⁹

Regulation also focuses sovereign wealth/public pension funds in other European nations on ESG investment by requiring pension funds to report on how they incorporate ESG in their investment strategies.¹⁸⁰ Beginning in 2016, the EU required member states to allow fiduciaries of occupational retirement funds to consider ESG factors in investment decisions and to mandate that these funds include in their investment

idUSKBN1WF1D]?smb=esg [https://perma.cc/E46M-DMX9] (describing an Invesco study finding the already heavily ESG-engaged sovereign wealth segment continues to expand its ESG investing activity, moving from forty-six percent “includ[ing] a top-down ESG policy” in 2017 to sixty percent in 2019).

¹⁷⁵ See *The Government Pension Fund*, GOVERNMENT.NO, <https://www.regjeringen.no/en/topics/the-economy/the-government-pension-fund/id1441> [https://perma.cc/JH2B-UKAP]; David Reid, *Norway's \$1 Trillion Sovereign Wealth Fund Grows Despite a Volatile Quarter for Markets*, CNBC, <https://www.cnbc.com/2019/08/21/norways-1-trillion-sovereign-wealth-fund-enjoys-returns-on-stocks-and-bonds.html> [https://perma.cc/TA3B-X7AM] (identifying Norway's sovereign wealth fund as “[t]he world's largest”).

¹⁷⁶ See Beate Sjøfjell et al., *Investing in Sustainability or Feeding on Stranded Assets? The Norwegian Government Pension Fund Global*, 52 WAKE FOREST L. REV. 949, 956–57 (2017).

¹⁷⁷ See *id.* at 956–60.

¹⁷⁸ See *The Government Pension Fund*, *supra* note 175.

¹⁷⁹ See Sjøfjell et al., *supra* note 176, at 959–60.

¹⁸⁰ See ERNST & YOUNG, *INVESTING IN A SUSTAINABLE TOMORROW: ESG INTEGRATION IN EUROPEAN PENSIONS* 6 (2017), [https://www.ey.com/Publication/vwLUAssets/ey-investing-in-a-sustainable-tomorrow/\\$FILE/ey-investing-in-a-sustainable-tomorrow.pdf](https://www.ey.com/Publication/vwLUAssets/ey-investing-in-a-sustainable-tomorrow/$FILE/ey-investing-in-a-sustainable-tomorrow.pdf) [https://perma.cc/8E43-2TD6] (summarizing European public pension fund ESG investment and regulation); see also Attracta Mooney, *ESG Wake-Up Call for Pension Laggards*, FIN. TIMES (Oct. 14, 2018), <https://www.ft.com/content/a681b422-91a3-11e8-9609-3d3b945e78cf> [https://perma.cc/4UMM-7PLB] (describing new UK rules that would require pension plan “trustees who disregard the long-term financial risks or opportunities from ESG will have to justify why this does not hurt their investment returns”).

policy disclosures how they take ESG issues into account in their investment practices.¹⁸¹ Just three years later, the European Parliament and EU member states agreed to extend these obligations to require institutional and other asset managers to integrate ESG factors into their investment decisions and to promulgate a uniform system for ESG disclosure by financial market participants.¹⁸² Even before the EU mandate, European assets made up a majority of the global ESG investment market.¹⁸³ The implementation of mandatory ESG integration across the EU market will only further swell ESG assets under management globally. Uniform disclosure demanded by this massive market share, when distilled and disseminated by investment intermediaries could also improve all investors' ability to match the ESG strategies they select to their preferences.

Although European players are in the lead, U.S. public pension assets are not far behind.¹⁸⁴ One recent report finds public funds represent fifty-four percent of U.S. ESG assets held by institutional

¹⁸¹ See Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the Activities and Supervision of Institutions for Occupational Retirement Provision (IORPs), 2016 O.J. (L 354) 37, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32016L2341> [<https://perma.cc/QN9Z-9468>].

¹⁸² See Press Release, European Comm'n, Capital Markets Union: Commission Welcomes Agreement on Sustainable Investment Disclosure Rules (Mar. 7, 2019), https://europa.eu/rapid/press-release_IP-19-1571_en.htm [<https://perma.cc/5MVE-F32E>]. This proposal was part of a suite of three proposed by the European Commission to improve capital deployment toward sustainable development. See *id.* Interest in ESG regulation in Europe continues. Steven Maijoor, Chair, European Sec. & Mkts. Auth., Sustainable Financial Markets: Translating Changing Risks and Investor Preferences into Regulatory Action (Feb. 12, 2020) (suggesting EU would also be moving on issuer disclosure regulation and anti-greenwashing efforts).

¹⁸³ See GLOB. SUSTAINABLE INV. ALL., 2016 GLOBAL SUSTAINABLE INVESTMENT REVIEW 7 (2017), http://www.gsi-alliance.org/wp-content/uploads/2017/03/GSIR_Review2016.F.pdf [<https://perma.cc/64L4-LBTQ>] (finding fifty-three percent of the \$22.89 trillion in global sustainable investments were in Europe); see also MORNINGSTAR, PASSIVE SUSTAINABLE FUNDS, *supra* note 35, at 6 (noting European dominance in passive sustainable investing as well, citing "an almost unbroken stream of positive quarterly net inflows"); *Sustainable Investing Grows on Pensions, Millennials*, *supra* note 4 ("Europe leads markets with about half of managed assets considering sustainability criteria, though growth appears to have leveled off (partly affected by methodology changes). Canada and U.S. interest continues to increase, while Japan is rising rapidly on government governance and pension fund efforts.").

¹⁸⁴ See Chris Taylor, *Sustainable Investing's Secret Weapon: Public Pensions*, REUTERS (Nov. 12, 2018, 12:52 PM), <https://www.reuters.com/article/us-money-investment-esg/sustainable-investings-secret-weapon-public-pensions-idUSKCN1NH24M> [<https://perma.cc/7RMV-ZCSW>].

investors.¹⁸⁵ California’s CalPERS and CalSTRS funds and the New York State Common Retirement Fund, the three largest U.S. public pension funds, have made explicit commitments to incorporate ESG into their investment decisions.¹⁸⁶ Starting in 2020, California law requires its public pension funds to report on the climate risk¹⁸⁷ in their portfolios, which may force them to seek out investment products with deeper and more accountable ESG commitments.

American public pension funds also practice engagement. They vote their shares directly, even when they invest through intermediary asset managers that vote on behalf of their other investor clients.¹⁸⁸ They seek informal influence with company leaders. They even take the more

¹⁸⁵ See US SIF, REPORT ON US SUSTAINABLE, RESPONSIBLE AND IMPACT INVESTING TRENDS 2018, at 4–5 (2018), <https://www.ussif.org/files/Trends/Trends%202018%20executive%20summary%20FINAL.pdf> [<https://perma.cc/W8AQ-PMX6>].

¹⁸⁶ See, e.g., *Environmental, Social, & Governance Integration*, CALPERS, <https://www.calpers.ca.gov/page/investments/sustainable-investments-program/esg-integration> [<https://perma.cc/3DMV-X7WK>] (last updated July 15, 2019) (“In 2016, each asset class developed a set of sustainable investment practice guidelines that reflects their needs and strategies.”); *ESG Investment Policy*, CALSTRS, <https://www.calstrs.com/esg-investment-policy> [<https://perma.cc/JP8P-B8RP>] (“CalSTRS incorporates PRI and other ESG principles into its investment policies and practices.”); *Corporate Governance*, OFF. N.Y. ST. COMPTROLLER, <https://www.osc.state.ny.us/pension/corporategovernance.htm> [<https://perma.cc/E22K-9RGK>] (noting the New York Fund’s engagement with portfolio companies places emphasis on “environmental, social and governance (ESG) issues”); Press Release, Thomas P. DiNapoli, Office N.Y. State Comptroller, State Comptroller DiNapoli Adds \$3 Billion to the State Pension Fund’s Sustainable Investment Program (Dec. 7, 2018), <https://www.osc.state.ny.us/press/releases/dec18/120718.htm> [<https://perma.cc/8L7C-FE5R>] (announcing the New York fund’s additional sustainable investment commitments, bringing its total to \$10 billion); OFFICE N.Y. STATE COMPTROLLER, NEW YORK STATE COMMON RETIREMENT FUND: ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORT (2017) [hereinafter NEW YORK STATE COMMON RETIREMENT FUND], <https://www.osc.state.ny.us/reports/esg-report-mar2017.pdf> [<https://perma.cc/RP4T-PKP2>] (reporting on the New York Common Retirement Fund’s ESG strategy to “incorporate[] ESG analysis more formally into all aspects of its investment process”).

¹⁸⁷ See CAL. GOV’T CODE § 7510.5 (West 2019) (requiring the public employee and teachers’ retirement fund boards to “publicly report on its analysis of the climate-related financial risk of its public market portfolio, including the alignment of the fund with the Paris climate agreement and California climate policy goals and the exposure of the fund to long-term risks”).

¹⁸⁸ See Griffith, *supra* note 34, at 9–10 (explaining that while “advisory firms require investors to delegate their voting rights as a condition to investing in the fund[,] . . . some large institutional investors—most notably, large pension funds—are able to negotiate exceptions to this rule”).

unusual step of filing shareholder proposals.¹⁸⁹ New York funds have been leaders in this area. Of the seventy-nine unique proposals public pension funds proposed to public companies at 2019 meetings, the New York City Comptroller submitted fifty-two.¹⁹⁰ The New York State Common Retirement Fund has also engaged heavily in this tactic, for example making forty-four proposals in 2018, most often addressing climate change, diversity, and political spending.¹⁹¹

Public fund pioneers seeded the sustainable investing and ESG markets and continue to play major roles in this growing sector. As the number of jurisdictions mandating ESG integration and disclosure increases, so will the ability of these major market players to demand the data and candor they require to match the ESG preferences of their beneficiaries with available investment products.

¹⁸⁹ See generally James R. Copland, *Special Report: Public Pension Funds' Shareholder-Proposal Activism*, PROXY MONITOR, <http://proxymonitor.org/forms/2015Finding3.aspx#notes> [<https://perma.cc/2XK5-2NHL>] (examining public pension funds' shareholder proposal activity and finding that "[f]rom 2006 to [2015], state and municipal pension funds have sponsored 300 shareholder proposals at Fortune 250 companies. More than two-thirds of these were introduced by the pension funds for the public employees of New York City and State").

¹⁹⁰ See SULLIVAN & CROMWELL LLP, 2019 PROXY SEASON REVIEW: PART 1: RULE 14A-8 SHAREHOLDER PROPOSALS 5 (2019), <https://www.sullcrom.com/files/upload/SC-Publication-2019-Proxy-Season-Review-Part-1-Rule-14a-8-Shareholder-Proposals.pdf> [<https://perma.cc/Z42F-875W>]. In prior years, the Comptroller has sometimes submitted even more proposals. As part of its multi-season efforts to increase proxy access, the Comptroller submitted seventy-one proposals on the topic in the 2017 season alone. See N.Y.C. COMPTROLLER, 2017 SHAREOWNER INITIATIVES: POST-SEASON REPORT 7, 11–13 (2017), https://comptroller.nyc.gov/wp-content/uploads/documents/2017_Shareowner_Initiatives_Postseason_Report.pdf [<https://perma.cc/HR8B-BPJM>] (detailing these efforts, as well as numerous shareholder proposals and other company engagements around gender pay equity, diversity, climate risk, and other ESG issues); see also DAVID WEBBER, THE RISE OF THE WORKING-CLASS SHAREHOLDER: LABOR'S LAST BEST WEAPON 63–74 (2018) (describing the NYC Fund's proxy access project in a work articulating the power and potential of pension funds more generally).

¹⁹¹ See SULLIVAN & CROMWELL LLP, 2018 PROXY SEASON REVIEW 4 (2018), <https://www.sullcrom.com/files/upload/SC-Publication-2018-Proxy-Season-Review.pdf> [<https://perma.cc/46AW-3TKV>]; see also NEW YORK STATE COMMON RETIREMENT FUND, *supra* note 186, at 4–6 (chronicling the Fund's shareholder proposal and other engagement activities over several years).

B. *Recent Converts*

When and if this ability to make better matches increases, more recent converts to the ESG investing market will benefit as well. Insurance companies are one key group of recent converts. They have quickly become a large segment of the ESG investment market, and their demand for ESG investment products continues to grow.¹⁹² A 2018 global survey of insurers found that well over half of “North American (59%) and European (58%) insurers have already adopted an ESG investment policy,” and another quarter or more expected to do so in the next year.¹⁹³

Zurich Insurance Group positions ESG integration of its investments as part of achieving its core goals. It explains: “To reduce risk and to help communities. These are among Zurich’s aims in providing insurance, and in managing its customers’ premiums. Responsible investment promises to achieve both, which has led us to adopt it in theory and in practice.”¹⁹⁴ Given insurers’ business exposure to environmental and social risks, especially those associated with climate change, they must hedge against these risks as they invest assets they will need to call upon to pay future claims.¹⁹⁵ The Asset Owners Disclosure Project recently issued a report demonstrating how these sophisticated players are carefully matching their impact and cost preferences with particular ESG investment products—beyond mere investment in the

¹⁹² See PETER UHLENBRUCH, SHAREACTION, ASSET OWNERS DISCLOSURE PROJECT, *INSURING A LOW-CARBON FUTURE* (2019), <https://aodproject.net/wp-content/uploads/2019/09/AODP-Insuring-a-Low-Carbon-Future-Full-Report.pdf> [<https://perma.cc/7SBT-2T3T>] (canvassing how more than a dozen insurance companies worldwide are integrating climate awareness “into underwriting, investment, and group-wide risk management practices”).

¹⁹³ BLACKROCK, *GLOBAL INSURANCE REPORT 2018*, at 33 (2018), <https://www.blackrock.com/institutions/en-us/literature/whitepaper/global-insurance-report-2018.pdf> [<https://perma.cc/UK8A-7VGK>].

¹⁹⁴ ZURICH, *DOING WELL AND DOING GOOD: WHY ZURICH PRACTICES RESPONSIBLE INVESTMENT* (2017), <https://www.zurich.com/-/media/project/zurich/dotcom/sustainability/docs/zurich-responsible-investment-position-statement-2017.pdf> [<https://perma.cc/NX2S-6LYW>].

¹⁹⁵ See William T.J. de la Mare, *Locality of Harm: Insurance and Climate Change in the 21st Century*, 20 CONN. INS. L.J. 189, 197–98 (2013) (“The underwriting and investment sides of insurance companies are interlinked in the sense that when investment returns are good, the insurance company may lower its rates to make them more affordable or competitive [I]n years when losses are relatively high, the insurer can rely on investment returns to make up for underwriting losses.”).

types of ESG mutual and ETF funds reviewed in our study. Due to the unique risks of climate change to which they are responding, insurers in the United States and Europe are using asset-level climate scenario analysis in their investment strategies, seeking fixed income investments from issuers that contribute to and benefit from long-term sustainability, weighting their portfolios toward companies contributing to energy and environmental transition, investing in green bonds, and more.¹⁹⁶

Although tiny in terms of assets under management, some U.S. foundations and other charitable endowments have also begun to devote more of their portfolios to ESG investing. Efforts to align endowment investing with the charitable purposes of an organization is often called mission-related investing. This classification can also include “impact investing,” which more often occurs through private and specialized investments and can contemplate intentionally concessionary financial returns in service of generating positive social impact.¹⁹⁷

Until quite recently, many foundations worried managing their endowments to pursue social along with financial returns was at odds with their fiduciary obligations and tax law expectations about foundation investment practices. Guidance from the Treasury in 2015 and the revised Uniform Prudent Management of Institutional Funds Act clarified that foundation managers have discretion to invest in line with the charitable purposes of their organizations.¹⁹⁸ The Ford Foundation credited the Treasury clarification as contributing to its decision to shift

¹⁹⁶ See ASSET OWNERS DISCLOSURE PROJECT, *supra* note 192, at 30–31.

¹⁹⁷ See Christopher Geczy et al., *In Pursuit of Good & Gold: Data Observations of Employee Ownership & Impact Investment*, 40 SEATTLE U. L. REV. 555, 560–63 (2017) (defining impact investment); Susan L. Abbott et al., *Impact Investing for Section 501(c)(3) Organizations*, 29 TAX’N EXEMPTS 17, 20 (2018) (distinguishing mission-related investment from other forms of impact investment).

¹⁹⁸ See *Investments Made for Charitable Purpose: Notice 2015-62*, IRS, <https://www.irs.gov/pub/irs-drop/n-15-62.pdf> [<https://perma.cc/BME5-T6D3>] (“When exercising ordinary business care and prudence in deciding whether to make an investment, foundation managers may consider all relevant facts and circumstances, including the relationship between a particular investment and the foundation’s charitable purposes.”); UNIF. PRUDENT MGMT. OF INSTITUTIONAL FUNDS ACT § 3(a), (e)(1)(H) (NAT’L CONFERENCE OF COMM’RS ON UNIF. STATE LAWS 2006) (allowing fiduciaries to “consider the charitable purposes of the institution” when making investment choices); see also Gary, *supra* note 25, at 786–89 (discussing ESG investment by charitable fiduciaries).

\$1 billion of its endowment to mission-related investments;¹⁹⁹ other foundation endowments large and small may follow suit.

Even skeptics recognize the appeal of market-rate ESG investment products that can align a foundation endowment's investment portfolio with its charitable mission.²⁰⁰ Investing foundation assets for social impact in products contemplating below-market risk-return profiles, on the other hand, remains controversial.²⁰¹ The new regulatory flexibility embodied by the 2015 Treasury Guidance frees foundations to consider whether they are willing to pay for higher-cost, potentially greater impact ESG products. To do so, however, they will need to be able to discern among the vastly divergent ESG products on the market.

C. *Untapped Potential*

Private retirement savers too may want to align their portfolios to their values, but the barriers to ESG investing by private U.S. retirement plan managers impose significant obstacles. ERISA fiduciary law properly focuses investment managers' decision-making on financial returns,²⁰² as experience has shown the risk of shortfalls in such plans are all too real. Each administration since the Clinton DOL has issued guidance clarifying these obligations for ERISA fiduciaries in the context of sustainable or socially responsible investments. The tone of these pronouncements has shifted back and forth—with Democratic administrations suggesting more openness and Republican ones

¹⁹⁹ See Darren Walker, *Unleashing the Power of Endowments: The Next Great Challenge for Philanthropy*, FORD FOUND. (Apr. 5, 2017), <https://www.fordfoundation.org/ideas/equals-change-blog/posts/unleashing-the-power-of-endowments-the-next-great-challenge-for-philanthropy> [https://perma.cc/8P58-Y2MG].

²⁰⁰ See, e.g., Marc Gunther, *Hewlett Foundation's Leader Makes a Case Against Impact Investing*, 31 CHRON. PHILANTHROPY 16 (2019) (reporting one foundation leader's views against impact investing by foundations, but who still believes ESG investing strategies "are fine as long as they don't sacrifice returns").

²⁰¹ See Marc Gunther, *Doing Good and Doing Well*, 31 CHRON. PHILANTHROPY 8 (2019) (reporting that "despite" considerable public discussion and advocacy for foundations to engage in impact investing, relatively few foundations engage in impact investing).

²⁰² See ERISA, 29 U.S.C. § 1104 (2018) (directing each ERISA fiduciary to "discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries . . . (A) for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan").

expressing more skepticism—up through the Trump administration’s announcement in April 2018. Throughout, the upshot has remained the same. In the words of the most recent guidance, “ERISA fiduciaries may not sacrifice investment returns or assume greater investment risks as a means of promoting collateral social policy goals.”²⁰³

Social policy considerations are not irrelevant; nor need ERISA fiduciaries be willfully blind to them. If non-financial issues will impact financial return, plans should consider them as they would any other factors in a prudent analysis of risk and return. However, “[f]iduciaries must not too readily treat ESG factors as economically relevant to the particular investment choices at issue when making a decision.”²⁰⁴

Those investments that can achieve social policy goals without sacrificing financial return are permissible.²⁰⁵ Fiduciaries of ERISA-regulated defined benefit plans, which steward plan assets to ensure specified payouts for recipients,²⁰⁶ can make ESG investments so long as they provide risk-adjusted market-rate returns. ESG investments may also be made available within ERISA-regulated defined contribution plans, also known as 401(k) or 403(b) plans, in which beneficiaries make their own investment choices among a menu of options curated by plan fiduciaries.²⁰⁷ Current DOL guidance explicitly states that including “a prudently selected, well managed, and properly diversified ESG-themed investment alternative”²⁰⁸ as one of several amongst which plan participants can choose can be permissible. It also emphasizes, however, that such choices are not appropriate default investment options, into which savers’ funds are placed unless they opt out.²⁰⁹

The DOL’s various guidance documents in this area have also addressed shareholder engagement. Again, the tone of their

²⁰³ Memorandum from John J. Canary, Dir. Regulations & Interpretations, Dep’t Labor, Field Assistance Bulletin No. 2018-01 (Apr. 23, 2018), <https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01> [<https://perma.cc/9XZS-KFQK>].

²⁰⁴ *See id.*

²⁰⁵ *See id.*

²⁰⁶ *See* Anne Tucker, *Retirement Revolution: Unmitigated Risks in the Defined Contribution Society*, 51 HOUS. L. REV. 153, 155–57 (2013).

²⁰⁷ *See id.* at 157.

²⁰⁸ *See* Memorandum from John J. Canary, *supra* note 203.

²⁰⁹ *See id.*

pronouncements tends to correlate with the policy preferences of the issuing administration. In its 2016 guidance, the Obama DOL stated that:

[a]n investment policy that contemplates activities intended to monitor or influence the management of corporations in which the plan owns stock is consistent with a fiduciary's obligations under ERISA where the responsible fiduciary concludes that there is a reasonable expectation that such monitoring or communication with management, by the plan alone or together with other shareholders, is likely to enhance the value of the plan's investment in the corporation, after taking into account the costs involved.²¹⁰

It also specifically contemplated engagement on “policies and practices to address environmental or social factors that have an impact on shareholder value” as well as a host of other issues.²¹¹ Guidance from the Trump DOL in 2018, however, explained that this earlier guidance “was not meant to imply that plan fiduciaries . . . should routinely incur significant plan expenses” to engage in advocacy on shareholder issues.²¹²

Despite the flexibility DOL guidance gives ERISA plan fiduciaries to consider ESG factors when they impact returns, to include ESG-themed choices in defined contribution plans, and to practice shareholder engagement when linked to value, ERISA fiduciaries understandably remain wary. The shifting tone of the Department's pronouncements across administrations is unsettling. Moreover, the tremendous variation we find across similarly branded ESG investment products will stymie efforts to identify appropriate ESG investments for ERISA-regulated plans. Absent robust, standardized ESG disclosures, sophisticated intermediaries will struggle to identify the right ESG investment to match beneficiary preferences and fiduciary duties.

The relatively high fees associated with ESG funds can further hamper retirement plan interest.²¹³ Consider the plight of the CalSavers

²¹⁰ 29 C.F.R. § 2509.2016-01 (2019).

²¹¹ *Id.*

²¹² Memorandum from John J. Canary, *supra* note 203.

²¹³ See Mark Miller, *Bit by Bit, Socially Conscious Investors Are Influencing 401(k)'s*, N.Y. TIMES (Sept. 27, 2019), <https://www.nytimes.com/2019/09/27/business/esg-401k-investing-retirement.html> [https://perma.cc/H4ZT-297X] (noting target-date funds' importance to defined-

program. The program is creating a new, publicly managed fund to provide California private sector workers with portable retirement savings. In an initial request for proposals, the program sought a suite of funds for retirement savers including an ESG option, but it was unable to find a sufficiently low-cost ESG option in this initial process.²¹⁴

In this environment, it is not surprising that uptake of ESG investments by private U.S. retirement plans has been limited. A 2018 study found only “16% of [defined contribution] plans offer a dedicated ESG option. However, this number masks a large divide among plans: Only 5% of corporate DC plans offer a standalone option, compared to the 43% of public and non-profit plans that do so.”²¹⁵ The numbers are increasing, but remain low. A 2019 study released by Callen, the same private ESG investment advisement firm, reports that thirty-six percent of defined contribution plans surveyed included an ESG fund in the lineup—the same percentage reported in BlackRock’s 2019 Institutional Investor Survey.²¹⁶ The regulatory and market barriers to inclusion of ESG offerings in ERISA-regulated plans, together with the opacity and variation our study finds among funds themselves, still frustrate retirement savers seeking ESG alternatives.

Signs suggest private pension plan ESG integration will increase. While only twelve percent of plan sponsors surveyed in 2018 reported incorporating ESG into selection of their fund managers, twenty-nine

contribution plan offerings and that “there’s an expense hurdle stopping target date funds from becoming socially responsible funds”).

²¹⁴ See Jon Hale, *3 Challenges for Getting ESG Funds into Retirement Plans*, MEDIUM (Sept. 2, 2018), <https://medium.com/the-esg-advisor/3-challenges-for-getting-esg-funds-into-retirement-plans-1ab62c1101ff> [<https://perma.cc/V8LA-M25E>] (describing the CalSavers struggle); see also Arleen Jacobius, *California Secure Choice Goes with Newton for CalSavers ESG Option*, PENSION & INV. (Jan. 29, 2019, 12:00 AM), <https://www.pionline.com/article/20190129/ONLINE/190129852/california-secure-choice-goes-with-newton-for-calsavers-esg-option> [<https://perma.cc/SG6W-7UGC>] (reporting CalSavers ultimately secured an ESG fund provider).

²¹⁵ James Veneruso, *Most DC Plans Don’t Feel ESG’s ‘Good Vibrations,’* CALLAN (May 29, 2018), <https://www.callan.com/esg-dc> [<https://perma.cc/D67C-FPVL>]. The frequent addition of a “brokerage window” option for 401(k) plan participants means that they theoretically could choose virtually any mutual fund or ETF on the market, along with a variety of other investment products. Utilization of this option, however, is extremely low for a variety of reasons. See Anne M. Tucker, *Locked In: The Competitive Disadvantage of Citizen Shareholders*, 125 YALE L.J. FORUM 163, 178 (2015).

²¹⁶ CALLEN INST., 2019 ESG SURVEY 18 (2019) (on file with authors); BLACKROCK, 2019 BLACKROCK DC PULSE SURVEY 31 (2019) (on file with authors).

percent indicated interest in doing so in the future.²¹⁷ Specialist Natixis Sustainable Future Funds has launched and widely publicized target-date ESG funds for inclusion in employer-sponsored plans.²¹⁸ Reports in 2018 suggested that Wells Fargo and BlackRock also had such vehicles under development, “betting that a surge in interest in environmental, social or governance investing will carry through to 401(k)s,”²¹⁹ but those offerings have yet to come online as both firms continue an education-first approach.²²⁰

The mix of economic and regulatory factors driving the uptake of ESG investing across different investor groups is unlikely to map perfectly to the variation across ESG investment products reported in our findings. Interest among individual investors is already significant and likely to grow, but how much and what kind of ESG these investors are willing to pay for remains unknown. Sovereign and public pension funds are major and enthusiastic ESG investors, with regulation poised to force even greater adoption as well as more uniform disclosure that may enable them to better navigate the variation across ESG investment products. Among other investor groups, uptake is more varied and uncertain. How well insurance companies and charitable endowments can discriminate among ESG offerings will determine how effective these recent converts will be at matching their preferences to available products—a process that would be aided by a more transparent ESG investment marketplace. The blend of regulatory uncertainty and high fees mean U.S. private pension plans are currently underrepresented in ESG investing. More clarity about the range of ESG commitments various products represent will

²¹⁷ See BRAD SMITH & KELLY REGAN, NEPC ESG SURVEY: A PROFILE OF CORPORATE & HEALTHCARE PLAN DECISIONMAKERS’ PERSPECTIVES (2018), <https://cdn2.hubspot.net/hubfs/2529352/files/2018%2007%20NEPC%20ESG%20Survey%20Results%20.pdf?t=1541714687871> [https://perma.cc/TG2P-7NB9].

²¹⁸ See *Natixis Sustainable Future Funds*, NATIXIS INV. MANAGERS, <https://www.im.natixis.com/us/natixis-sustainable-future-funds> [https://perma.cc/2T3F-UNNX] (offering ten target-date alternative active ESG funds).

²¹⁹ Melissa Karsh & Emily Chasan, *BlackRock, Wells Fargo Are Betting on Ethical Investing Funds for 401(k)s*, BLOOMBERG (June 13, 2018, 5:00 AM), <https://www.bloomberg.com/news/articles/2018-06-13/blackrock-wells-fargo-are-said-to-push-esg-funds-for-401-k-s> [https://perma.cc/6XUF-YEQ4].

²²⁰ See e.g., John Manganaro, *Sponsors Can Expect Expanding ESG Opportunities*, PLANSPONSOR (Apr. 16, 2019) (quoting Ron Cohen, Wells Fargo Asset Management’s head of defined contribution investment only (DCIO) sales); see also, BLACKROCK, *supra* note 216, at 29–31.

likewise be required to unleash this still untapped potential. The final category of institutional investors—fund complexes themselves—are also key players in developing the ESG market. The next Part considers their complementary role as suppliers of ESG investment products.

III. UNMASKING ESG SUPPLY SIDE DRIVERS

Diverse supply side forces also drive ESG asset growth and contribute to ESG market heterogeneity and opacity. For example, fund creators compete with each other on fund performance and fees, and each seeks to differentiate its offerings from those of its competitors in a crowded investment management market. Funds must also retain established clients and draw in new ones and design products that will generate revenue to support the fund complex's bottom line.²²¹ ESG investing presents opportunities for fund creators to serve their own interests in each of these ways and masking ESG product variation can often enhance these opportunities for generalist funds. Rising interest in ESG investing has also generated a huge market opportunity for the providers of ESG indices and metrics, who are likewise capitalizing on this key moment. This Part considers how fund creators' and index providers' responses to these pressures and opportunities are contributing to the development of ESG investing.

Supply side market forces are largely unbridled because investment law has little to say about the substance of ESG investing.²²² A combination of investor "control" over investment allocations and intermediated fiduciary duties through employer plan sponsorships leaves investment products and retirement investors in a largely

²²¹ Vanguard would argue its unique structure differentiates it from its competitors on this score. See *Why Ownership Matters*, VANGUARD, <https://about.vanguard.com/what-sets-vanguard-apart/why-ownership-matters/#targetText=Our%20unique%20client%20Downed%20structure,%22mutual%22%20mutual%20fund%20company> [https://perma.cc/8JU4-3TYU]. It remains, however, a company focused on remaining a significant and profitable market player.

²²² At the portfolio company level, too, law plays a minor role. Corporate statutes are generally silent as to corporate objectives and whether and to what extent corporate fiduciaries should consider sustainability and other social concerns is rarely litigated. See Dana Brakman Reiser, *Progress Is Possible: Sustainability in US Corporate Law and Corporate Governance*, in *THE CAMBRIDGE HANDBOOK OF CORPORATE LAW, CORPORATE GOVERNANCE AND SUSTAINABILITY* 131, 134–37 (Beate Sjøfjell & Christopher M. Bruner eds., 2019).

unregulated space, save for the standard financial disclosures required and claims facilitated by SEC regulations.²²³ Fund compliance officers likely disagree when peering from under the web of regulation, but from a consumer standpoint investment products are a low-regulatory environment where market forces dominate. Index providers operate completely outside of regulation, offering private products answerable to no one.²²⁴ When developing ESG investment products, fund complexes and index providers in this low-regulation environment respond to the financial incentives that motivate them: increasing market share (and AUM for fund complexes) and earning fees.

As the evidence shifts to accept that ESG factors influence financial returns, fund families' business models are implicated directly. If funds perform better financially when investments excel on ESG factors, fund complexes can boost AUM and expand market share by outperforming competitors on ESG integration. To seize this opportunity, funds will develop active funds that consider ESG as they select investments and implement the methods of ESG investing that best align with financial return. In their passive fund portfolios, fund creators will pursue ESG indices and other metrics that likewise align with financial performance. While ESG engagement strategies might help active and passive funds alike to mitigate risk, passive funds' relative lock-in to the firms within a given index increase the importance of engagement for this market segment.

BlackRock, the largest U.S. investment company, signals the growing link (or at least messaging) between ESG factors and financial return. BlackRock, typifying a shifting market ethos, has reimagined itself as a force for good.²²⁵ In recent years, the mutual fund giant has committed to increased ESG investing. Perhaps most prominently, BlackRock Chairman and CEO Larry Fink expressed concern in his 2018 letter to CEOs of its investee companies that

²²³ As one author has written about separately, federal regulation of retirement plans is piecemeal and trifurcated between the DOL, Internal Revenue Service, and SEC leaving everyone, and *no one*, driving retirement plans the way beneficiaries may assume. See Tucker, *supra* note 206, at 215–18 (discussing the oversight and structural limitations of ERISA regulations).

²²⁴ See *Market Indices*, SEC, <https://www.sec.gov/fast-answers/answersindiceshtm.html> [<https://perma.cc/FEG3-BRV3>] (explaining that “[t]he SEC does not regulate the content of these indices” used to compose indexed mutual funds and ETFs).

²²⁵ BLACKROCK, <https://www.blackrock.com/corporate#intro> [<https://perma.cc/83VH-S4XH>].

[t]o prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate.²²⁶

Fink pledged BlackRock would use its considerable clout with portfolio companies to demand long-term growth strategies that take sustainability issues into account, at least as they contribute to growth and profitability. Despite mixed responses to the 2018 letter, the following two years' missives doubled down on the ESG theme. Fink asserted that "profits and purpose are inextricably linked,"²²⁷ "sustainable investing is the strongest foundation for client portfolios," and "purpose is the engine of long-term profitability."²²⁸

Corporate leaders, too, are signaling their support. The Business Roundtable, the preeminent U.S. association of large corporations,²²⁹ released a statement in the summer of 2019 backing away from the shareholder primacy perspective it had long espoused. Instead, it announced that companies "share a fundamental commitment to all of our stakeholders," including customers, employees, and suppliers, as well as shareholders, and a commitment "to deliver value to all of them, for the future success of our companies, our communities and our country."²³⁰ Earnings calls by individual companies increasingly address ESG issues as well.²³¹ Even the *Financial Times* joined the chorus, with an

²²⁶ Letter from Larry Fink, Chairman & Chief Exec. Officer, Blackrock, to CEOs (Jan. 12, 2018), <https://www.nytimes.com/interactive/2018/01/16/business/dealbook/document-BlackRock-s-Laurence-Fink-Urges-C-E-O-s-to-Focus.html?dlbk> [<https://perma.cc/VF34-FL5V>].

²²⁷ Letter from Larry Fink, Chairman & Chief Exec. Officer, BlackRock, to CEOs (Jan. 16, 2019) [hereinafter 2019 Letter from Larry Fink], <https://www.blackrock.com/americas-offshore/2019-larry-fink-ceo-letter> [<https://perma.cc/Z7MG-DKYB>].

²²⁸ Letter from Larry Fink, *supra* note 10.

²²⁹ See *About Us*, BUS. ROUNDTABLE, <https://www.businessroundtable.org/about-us> [<https://perma.cc/8FD2-6V5S>].

²³⁰ *Our Commitment*, *supra* note 11.

²³¹ See Karen Langley, *More Companies Are Making Noise About ESG*, WALL ST. J. (Sept. 23, 2019, 2:33 PM), <https://www.wsj.com/articles/more-companies-are-making-noise-about-esg-11569263634> [perma.cc/T969-LVGT] (reporting "[t]wenty-four companies in the S&P 500 mentioned the acronym 'ESG' on earnings conference calls between June 15 and Sept. 14, double the number . . . in the first quarter" and an enormous jump from two years earlier when only two had done so).

opinion from its editorial board arguing “retail savers and the investment industry should embrace a corporate perspective that looks beyond the narrow bottom line to take into account companies’ impact on climate and environment, workers and the communities they operate in” as a way to enhance corporate value over the long term.²³²

These developments are also propelled by the swelling importance of millennials as employees, consumers, and investors. For example, Fink’s 2019 letter explained, “[a]s wealth shifts and investing preferences change, environmental, social, and governance issues will be increasingly material to corporate valuations.”²³³ Not all fund complexes will climb out as far on the ESG limb as BlackRock claims to be going, but generational shifts will impact them all. If Fink’s predictions are borne out, other fund complexes—whether in or outside of the public eye—will need to ramp up their reputation for responding to ESG issues to keep their funds’ returns competitive and appeal to the investors of the future. Scholars Michal Barzuza, Quinn Curtis, and David H. Webber have forcefully argued this shift is already occurring.²³⁴ Fielding ESG investments, no matter where they fall on the spectra of cost and impact, will help build reputational capital²³⁵ with this increasingly important demographic.

ESG funds offer fund complexes benefits beyond the assets invested in ESG funds themselves. Consider retirement plan administrators creating the highly curated investment menu (in the ballpark of twenty

²³² Editorial Board, *Investors Should Look Beyond the Bottom Line*, FIN. TIMES (Oct. 21, 2019), <https://www.ft.com/content/30b3b8d2-f014-11e9-ad1e-4367d8281195> [<https://perma.cc/B4QK-DVNP>].

²³³ 2019 Letter from Larry Fink, *supra* note 227; *see also* Langley, *supra* note 231 (identifying “[o]ne contributing factor [as] a transfer of wealth to members of the millennial generation, who as a group are more focused on sustainability”).

²³⁴ *See* Michal Barzuza et al., *Shareholder Value(s): Index Fund Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. (forthcoming 2020) (manuscript at 47–53), <https://ssrn.com/abstract=3439516> [<https://perma.cc/GMG9-VZZQ>] (arguing index funds significant engagement and voting activity on matters of social activism can be explained by their desire to compete for the current and future investment business of the millennial generation).

²³⁵ *Cf.* Claire A. Hill, *Marshalling Reputation to Minimize Problematic Business Conduct*, 99 B.U. L. REV. 1193, 1213 (2019) (arguing that business reputation—both in avoiding “reputational risk events” and in creating a generally positive image among consumers, regulators, and others—aligns with profitability).

funds)²³⁶ for participants to allocate their retirement savings. Including ESG funds in a fund family facilitates direct investment opportunities in those funds, but it may also garner goodwill about the fund family, facilitating investment in traditional products carried by a fund with both ESG and traditional offerings.

Thereby, advertising for ESG-related vehicles can be used to influence fund flows to a fund family's ESG and non-ESG products alike. For example, in 2018, coinciding with the largest fund flow to passive funds ever at the time, TIAA-CREF launched a new advertising campaign for Nuveen, the firm's ESG investing arm. The campaign was titled "investing by example" and included video content for Internet and television, and nationwide billboard and print advertising.²³⁷ The campaign focused on the positive ripple effect of investments with the line, "When we invest in a world we're proud to leave behind, it isn't just business as usual. It's investing by example."²³⁸ The campaign contained intentional features to reach baby boomers as well as young investors; for example, it used a band popular with millennials to play a cover of the 1970s band the Carpenters. The ads also harkened back to TIAA-CREF's founder, Andrew Carnegie, and linked the legacy investment arm with the new ESG practice.²³⁹

Critically, ESG investing also provides fund complexes with a welcome counterbalance to the passive investing trend and its negative effect on fees. Fund complexes rely for revenues in large part on the higher fees paid for active fund investments.²⁴⁰ As data emerged showing passive funds consistently outperforming their active counterparts, particularly when returns are considered net of fees, fund flows to passive strategies increased, and active managers have come under pressure to

²³⁶ See, e.g., Janice Kay McClendon, *The Death Knell of Traditional Defined Benefit Plans: Avoiding a Race to the 401(k) Bottom*, 80 TEMP. L. REV. 809, 831 (2007) (citing an average of eighteen choices in a defined contribution plan menu).

²³⁷ MullenLowe, *Nuveen—Investing by Example*, DRUM (Sept. 2018), <https://www.thedrum.com/creative-works/project/mullenlowe-nuveen-investing-example> [<https://perma.cc/RH94-QA2A>].

²³⁸ @NuveenInv, TWITTER (Sept. 20, 2018, 11:01 AM), <https://twitter.com/NuveenInv/status/1042790840287027201> [<https://perma.cc/HF5D-XWVT>].

²³⁹ MullenLowe, *supra* note 237.

²⁴⁰ See Fisch et al., *supra* note 47, at 36–37 (reporting that even passive fund specialists like Vanguard field numerous active funds).

reduce fees or justify them in some way.²⁴¹ The costs and challenges of ESG investment can be used to support active management strategies and to justify higher fees in actively and passively managed funds alike.

After all, even funds marketed as ESG index products often include some active elements like screening—and associated higher fees.²⁴² Relatively higher-fee ESG offerings can thus offset lower fees earned on ordinary indexed assets and fund flow favoring passive strategies.²⁴³ In this way, ESG investment products can also strategically respond to the existential threat fund complexes face from the rise of passive investing.

The growing pool of investors demanding alignment of their investments with their values may accept that strong ESG investment performance justifies higher fees. As suggested by the variation of ESG commitment our study reports, it will be difficult and costly for high-ESG investors to determine which ESG investment products provide the best match for their preferences. Without more transparent and consistent information about how funds live up to their ESG label, individual and institutional investors will be unable to investigate the matter thoroughly and act accordingly.

When obscured, ESG variation also invites a broader market harm that combines greenwashing and free-riding.²⁴⁴ High ESG funds may be fueling sector development in green energy or clean water, generating anecdotal evidence of high ESG impact. The anecdotes and goodwill of such highly committed ESG funds can spill over to less committed ESG funds when investors cannot differentiate between their claims of ESG effort or impact. For example, consider the Vanguard FTSE Social Index, a fund in our ESGP sample that voted against every ESG proposal we

²⁴¹ See Charles Stein et al., *Free Fidelity Funds Stoke Price War in Bid to Catch Index Giants*, BLOOMBERG (Aug. 1, 2018, 11:08 AM), <https://www.bloomberg.com/news/articles/2018-08-01/fidelity-to-offer-index-mutual-funds-with-zero-expense-ratio> (describing how all of the major mutual fund and ETF providers are engaged in fee reduction to capture investors seeking low-price options).

²⁴² See, e.g., Praxis Growth Index Fund A, *supra* note 155.

²⁴³ See MORNINGSTAR, *supra* note 3, at 27–28 (positing that fund creators repurposing actively managed funds experiencing outflows “would not be surprising”). Future work could examine the relationship between fund flows out of actively managed funds and the rise of ESG funds.

²⁴⁴ Greenwashing is when companies, or here, investment firms, mislead consumers (investors) about the social or environmental benefits of their products or services. For a discussion of greenwashing, see Magali A. Delmas & Vanessa Cuerel Burbano, *The Drivers of Greenwashing*, 54 CAL. MGMT. REV. 64 (2011).

tracked between 2018–2019 and which held exclusively household name brand companies in its top ten holdings for both years (including Wells Fargo, JP Morgan, Citigroup, Mastercard, and Visa). Vanguard ESG marketing boasts its ESG investment options are funds “[w]here your money can reflect what matters to you.”²⁴⁵ Absent market discipline provided by clear signals to high ESG-committed investors to invest in high-ESG funds, low-ESG funds have little incentive to increase their own ESG. Further, high-ESG funds subsidize the ESG brand while potentially losing committed ESG capital.

The variation we find across ESG investment products is also driven in part by the firms providing ESG metrics, benchmarking ESG performance, and, most importantly, designing ESG indices. As noted above, intermediaries that produce and sell these opaque systems, like MSCI and FTSE Russell, play an outsized role in ESG indexed equity funds.²⁴⁶ By at least one measure, metric and index providers also appear to be pursuing widely disparate visions or applications of ESG. A 2018 study by Schroders found a remarkable “lack of consistency in ESG scores between the main data providers.”²⁴⁷ An Economist study of two major ESG rating firms found “ESG scores are poorly correlated with each other.”²⁴⁸ This variation makes sense in a growing industry, in which each player is seeking to gain market share and justify its fees to potential fund complex customers.

Beyond their contribution to the variation our study finds, it is important to note the tremendous influence index and other ESG metric providers wield over how institutional investors will prioritize and operationalize ESG factors. They quite literally are setting the standards for what counts as ESG. By dint of their power in the investment

²⁴⁵ *ESG Investing: Where Your Money Can Reflect What Matters to You*, VANGUARD, <https://investor.vanguard.com/investing/esg> [<https://perma.cc/73Z4-SP3F>].

²⁴⁶ See *supra* text accompanying notes 89–92. New players are also hurtling into the ESG metric field. See Billy Nauman, *Credit Rating Agencies Join Battle for ESG Supremacy*, FIN. TIMES (Sept. 16, 2019), <https://www.ft.com/content/59f60306-d671-11e9-8367-807ebd53ab77> [<https://perma.cc/GAH8-59YL>] (describing “Moody’s and S&P Global, two of the big three credit rating agencies” as “elbowing their way in, offering separate ESG scores on companies in addition to their traditional assessments of creditworthiness”).

²⁴⁷ See Ovidiu Patrascu, *Index-Based ESG Strategies: Key Things to Watch for*, SCHRODERS (Aug. 10, 2018), <https://www.schroders.com/en/us/institutional/thought-leadership/sustainability/index-based-esg-strategies-key-things-to-watch-for> [<https://perma.cc/67QZ-8HPT>].

²⁴⁸ *ESG Investing: Poor Scores*, ECONOMIST, Dec. 7, 2019, at 67.

marketplace, these very private players also will impact the ESG goals to which portfolio companies will aspire. To appease their clients and maintain their market dominance, index and metric providers will naturally seek to identify new, different, value-added ways to measure or index for ESG factors that contribute to financial performance, but these may or may not align with either investor preferences or societal needs in these areas. The private nature of the indices means neither investors nor the rest of us will likely ever know.

IV. ANALYSIS AND RESPONSES

Over the last decade, enormous amounts of money have flown into ESG and now ESG index funds, driven by a combination of demand-side and supply-side forces. Whether motivated by their individual values, legal requirements, or a vision of ESG factors driving financial return, investors are seeking products that respond to systemic risk, climate change, and social inequality whether in name or practice. Fund creators' relentless pursuit of tools to better predict financial return, as well as their desire to increase market share and enhance revenues in an industry rocked by the rise of passive investing, are leading them to supply a dizzying array of ESG products. Passive ESG products in turn are increasingly linked to opaque and unaccountable specialty indices. In ESG investing's low-regulation environment, these market forces are largely unchecked.

The variety and opacity of ESG funds leaves even a diligent and well-intentioned investor without assurance that an ESG investment, and even more so one in an ESG index fund, will match her preferences. It is beyond the scope of this Article to comprehensively consider the market-based and regulatory strategies for improving ESG products' ability to satisfy investor expectations and harness the investment market to improve environmental and social sustainability. In this Part, however, we briefly sketch some promising alternatives and identify areas for exploration in future research.

The market, already the most powerful force in this low-regulation space, is one promising place to seek improvement in ESG investing. If investors, both individual and institutional, demand more clarity about ESG practices and commitments, fund creators can be expected to respond. On the individual side, we can expect the growing financial

weight of women and millennials to continue to increase demand for more and better ESG investing performance over branding. Like all individual investors, though, they face coordination problems and information deficits. Therefore, intermediary behavior will be key. Expert investment intermediaries can demand greater clarity and assessment from fund creators, especially if the potential of ERISA markets can be tapped. On the institutional side, a combination of business goals and legal dictates will also increase demands for reliable and transparent ESG investment products. Sustained evidence linking ESG investing to financial performance will intensify institutional investors' demands for real and accountable ESG integration. Disclosure requirements in the EU are already driving ESG innovation and transparency. If this major market mandates its largest players to integrate ESG, it will in turn push fund creators worldwide to offer complying and transparent products.

The impact of regulation already being felt in Europe is just one example of how legal intervention can play a positive role in improving ESG investing's ability to deliver across the range of ESG investor preferences. It seems far-fetched to imagine U.S. regulators imposing ESG integration mandates.²⁴⁹ Disclosure requirements on companies and funds, however, could be updated to include information on ESG factors.²⁵⁰ Much of the discussion around ESG or sustainability disclosure in the United States has revolved around issuer (as opposed to fund) obligations.²⁵¹ Currently, securities regulation imposes no broad-based

²⁴⁹ Bills to this effect have been introduced in Congress but have not progressed very far. See, e.g., ESG Disclosure Simplification Act of 2019, H.R. 4329, 116th Cong. (2020) (mandatory ESG reporting legislation introduced in the House).

²⁵⁰ Consumer facing financial disclosure is a favored regulatory intervention, but one with haunting criticisms around investors' use. Homer Kripe vehemently made this case with the "hypothesis . . . that the prospectus is intended for the man in the street, the unsophisticated lay investor . . . is a myth . . . [and] largely responsible for the fact that the securities prospectus is fairly close to worthless." Homer Kripke, *The Myth of the Informed Layman*, 28 BUS. LAW. 631, 632 (1973); see also Tom C.W. Lin, *Reasonable Investor(s)*, 95 B.U. L. REV. 461, 466–68 (2015) (defining reasonable investors); Charles R. Korsmo, *The Audience for Corporate Disclosure*, 102 IOWA L. REV. 1581, 1586–87 (2017) (introducing a taxonomy of securities disclosure audiences). Our disclosure suggestion rests upon assumptions of a sophisticated intermediary such as analysts or retirement professionals to distill and disseminate disclosure contents to investing consumers.

²⁵¹ See, e.g., Ann M. Lipton, *Mixed Company: The Audience for Sustainability Disclosures*, 107 GEO. L.J. ONLINE 81 (2018) (arguing issuer disclosures should more broadly address sustainability); Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, 107 GEO. L.J. 923, 952–56 (2019) (advocating a new mandatory sustainability discussion and analysis section of issuers' annual

requirement for companies to engage in such disclosures,²⁵² although companies frequently issue voluntary disclosures styled as corporate responsibility or sustainability reports.²⁵³ Organizations like the Global Reporting Initiative²⁵⁴ and Sustainability Accounting Standards Board²⁵⁵ offer tools to standardize this voluntary reporting, but at the moment voluntary company reports remain diverse and often difficult to compare.²⁵⁶ The conversation about issuer disclosure is important, but resolving it will not necessarily provide fund investors with sufficient information. When they invest in funds combining scores of individual issuers, disclosures around the ESG practices of a fund or its associated index would be far more informative.²⁵⁷ The European experience can help U.S. regulators distill the focus and content of any disclosure

disclosures); Roberta S. Karmel, *Disclosure Reform—The SEC Is Riding off in Two Directions at Once*, 71 BUS. LAW. 781 (2016); see also Business and Financial Disclosure Required by Regulation S-K Release No. 33-10064, at 206-15 (Apr. 13, 2016), <https://www.sec.gov/rules/concept/2016/33-10064.pdf> [<https://perma.cc/YUQ8-UAGS>] (requesting comments on whether the SEC should mandate sustainability disclosure by issuers).

²⁵² For the SEC's most recent efforts at more targeted ESG disclosure, see Modernization of Regulation S-K Items 101, 103, and 105 Release Nos. 33-10668, 34-86614, at 48 (August 8, 2019), <https://www.sec.gov/rules/proposed/2019/33-10668.pdf> [<https://perma.cc/2SA4-N7VD>] (proposing to replace a reporting obligation to merely state its number of employees with “a description of the registrant’s human capital resources, including . . . human capital measures or objectives that management focuses on in managing the business”); see also Fisch, *supra* note 251, at 947–52 (describing the lack of SEC mandates in this area, with discussion of limited disclosure obligations it has imposed around climate change and board diversity).

²⁵³ See KPMG, THE ROAD AHEAD: THE KPMG SURVEY OF CORPORATE RESPONSIBILITY REPORTING 2017, at 4 (2017), <https://assets.kpmg/content/dam/kpmg/xx/pdf/2017/10/kpmg-survey-of-corporate-responsibility-reporting-2017.pdf> [<https://perma.cc/736M-KJQJ>] (finding “CR reporting is standard practice for large and mid-cap companies around the world” with three-quarters of companies surveyed engaging in the practice).

²⁵⁴ See *About GRI*, GLOBAL REPORTING INITIATIVE, <https://www.globalreporting.org/information/about-gri/Pages/default.aspx> [<https://perma.cc/WH28-CR7J>].

²⁵⁵ See *Standards Overview*, SUSTAINABILITY ACCT. STANDARDS BOARD, <https://www.sasb.org/standards-overview> [<https://perma.cc/4VH2-KQVU>].

²⁵⁶ See Fisch, *supra* note 251, at 944–46; Jill M. D’Aquila, *The Current State of Sustainability Reporting: A Work in Progress*, CPA J. (July 2018), <https://www.cpajournal.com/2018/07/30/the-current-state-of-sustainability-reporting> [<https://perma.cc/9ZV7-P5EX>].

²⁵⁷ Cf. STEPHEN DAVIS ET AL., WHAT THEY DO WITH YOUR MONEY: HOW THE FINANCIAL SYSTEM FAILS US AND HOW TO FIX IT 139–41 (2016) (addressing the need to regulate investment intermediaries); see also Doug Chia, *Big ESG*, SOUNDBOARD GOVERNANCE (Nov. 11, 2019), <https://www.soundboardgovernance.com/post/big-esg> [<https://perma.cc/ZKT5-88EU>] (arguing that company ESG disclosure rewards volume over quality).

mandates it might impose on investment companies, and future work in this area is warranted.

Another legal intervention to increase the transparency and effectiveness of ESG investing would take advantage of a different set of investment market actors: private employers and their retirement plan administrators. As discussed above, operating in the shadow of often dire DOL warnings about non-financial investment considerations, these ERISA fiduciaries currently make relatively little use of ESG investment products. This barrier should be removed or reframed to seize upon growing links between ESG performance and financial performance, particularly over the long-term, and its consequent compatibility with retirement savings goals. In doing so, however, the DOL should prod ERISA fiduciaries to become demanding consumers of ESG products, requiring transparent and consistent disclosures of ESG strategies, and their impact on fees, diversification, and tracking error. Fund creators not wanting to miss out on the enormous ERISA-regulated asset market would have significant incentives to respond.

Regulating index providers is yet another route to improving the content, consistency, and transparency of ESG investment products. By creating the metrics that fuel ESG investing, these thoroughly private players wield great public power over markets—and more. One need only look to the role of the rating agencies in the 2008 financial crisis to be reminded of the tremendous impact seemingly unassuming metric providers can produce.

European regulation has again been at the forefront here, with its European Benchmark Regulation in force since January 2018. This Regulation creates “a common framework to ensure the accuracy and integrity of indices used as benchmarks in financial instruments and financial contracts, or to measure the performance of investment funds in the Union.”²⁵⁸ It was prompted by scandals like LIBOR²⁵⁹ and concerns

²⁵⁸ See Regulation (EU) 2016/1011, of the European Parliament and of the Council of 8 June 2016 on Indices Used as Benchmarks in Financial Instruments and Financial Contracts or to Measure the Performance of Investment Funds, 2016 O.J. (L 171) 1, art. I, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2016.171.01.0001.01.ENG&toc=OJ:L:2016:171:TOC [<https://perma.cc/3PQN-LCK4>].

²⁵⁹ See *id.* (noting in the preamble at (1) that “[s]erious cases of manipulation of interest rate benchmarks such as LIBOR and EURIBOR, as well as allegations that energy, oil and foreign exchange benchmarks have been manipulated, demonstrate that benchmarks can be subject to conflicts of interest”).

about the growing influence and concentration of index providers in the passive investing space more generally, and not with ESG indices in mind. Its authority sweeps broadly, however. Whether it will be effective in constraining index providers, and in what ways, will depend on how it is implemented. But index providers seeking to operate in the EU market (read: virtually all of them and certainly all of the big ones) are watching.

The topic of index regulation looms large on the U.S. regulatory horizon as well. The massive shift of investment assets under management to passive strategies empowers private index providers. They are generating huge profits and the market is consolidating.²⁶⁰ The longstanding view that index providers are mere publishers, not subject to regulation as investment advisors,²⁶¹ is ripe for revision. The ESG context, where index providers devise bespoke indices, sometimes for use by a single fund, is an example of the declining utility of the publisher analogy. Review of the idea that a fund's disclosure that it uses a particular index is sufficient without greater elaboration is likewise overdue. The SEC's recent proposed regulations on ETFs failed to address index regulation, but this effort certainly drew its attention to the explosive growth and power of index providers.²⁶² If and when the SEC sets its

²⁶⁰ See Naumann, *supra* note 246 (describing the large and growing market for ESG ratings); Dieter Holger, *ESG Investing Trend Has Powered Index Giant MSCI to Market Outperformance in 2019*, MARKETWATCH (Sep. 12, 2019, 3:43 PM), <https://www.marketwatch.com/story/esg-investing-trend-has-powered-index-giant-msci-to-market-outperformance-in-2019-2019-09-12> [perma.cc/7G7M-YRNC].

²⁶¹ The Investment Advisors Act exempts publishers “of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation” from its regulatory purview, 15 USC § 80b-2(a)(11)(D) (2018), and the U.S. Supreme Court opined that the exemption warranted a “broad reading,” *Lowe v. SEC*, 472 U.S. 181, 183, 204–05 (1985). Index providers rely on their position providing general, rather than client-centered, evaluation and advice to avoid regulation. See Rachel Evans, *A \$3.6 Trillion Regulatory Hole Around ETFs Gets SEC Scrutiny*, BLOOMBERG (July 18, 2018, 10:51 AM), <https://www.bloomberg.com/news/articles/2018-07-18/a-3-trillion-regulatory-hole-surrounding-etfs-gets-sec-scrutiny> [https://perma.cc/DNH6-CH9H].

²⁶² See Exchange Traded Funds Release Nos. 33-10515, IC-33140, at 11 (June 28, 2018), <https://www.sec.gov/rules/proposed/2018/33-10515.pdf> [https://perma.cc/589S-YXVS] (discussing ETFs' reliance not only on “broad-based” but also “specialized,” “customized or bespoke indexes”); see also Dalia Blass, Dir., SEC Division Inv. Mgmt., Keynote Address, ICI 2018 Mutual Funds and Investment Management Conference (March 19, 2018), <https://www.sec.gov/news/speech/speech-blass-2018-03-19> [https://perma.cc/T8SK-A3KY] (suggesting, in a speech “only for myself and not for the Commission, the Commissioners or the staff,” that innovation in the index market may mean it is time to “revisit” these regulatory issues).

sights on index regulation, the particular challenge of making ESG indices transparent and accountable must be part of the conversation.

CONCLUSION

The promise of ESG investing in general, and passive ESG in particular, is enormous: guilt-free and lower-cost retirement savings for the conscientious consumer investor. Despite its astounding recent growth in AUM and the widely publicized embrace of stakeholderism from so many quarters across the business community, investors will have difficulty identifying products to match their ESG preferences. The offerings in this essentially unregulated market are endlessly varied and its use of ESG factors is opaque. ESG investment strategies are difficult to parse and nearly impossible to compare. Portfolio holdings and fund voting records vary widely in how much they differ from non-ESG alternatives. Investigating any of these differences across the field of funds is a monumental task. One possible way to sort the range of ESG investment products is between lower-fee generalist ESG funds and higher-fee specialty ESG funds with a thematic investment focus such as clean water. Specialty ESG funds, while expensive, offer the most ESG-distinctive strategies, holdings, and voting patterns in our case study, suggesting that perhaps investors get the ESG that they pay for.

With only such rough guidance, gaining traction on the difficult matching problem in the massively expanding pool of new (or rebranded) ESG investment products will require more than passionate declarations of purpose by industry leaders. At present—at least in the United States—the ESG aspects of these products are unregulated. Fund creators and index providers are pursuing their own interests in increasing revenues and market share by cultivating a market in which ESG functions as branding to signal a normatively “good” fund. In reality, the investment landscape is highly variable in terms of ESG differentiation and those variations are not facially obvious. As demand for ESG investment products increases across a range of investors and geographies, investors may propel fund creators and index providers to improve ESG distinctiveness and transparency. Market forces alone, though, are unlikely to correct the incentives for opacity and variation that risk widespread mismatching. In contrast, changes to securities disclosure mandates, ERISA law, and index regulation could hasten improvements.

Solving the ESG investor matching puzzle is critical and could do great good, but the power of business to tackle environmental social problems should not be oversold. Market players in ESG investing can be expected to continue to act in their own self-interest, even if pressure for consistency and transparency from customers or regulators increases. When this self-interest aligns with the interests of society—and especially when environmental and social responsibility aligns with financial return—the rest of us can free ride. But nobody should expect a complete overlap. Even if consistency and transparency in ESG investing improves, additional efforts by governments, the private sector, and countless individual actors are necessary to make real progress on many systemic challenges facing global society today.

APPENDIX I

Sample Funds

ESG Funds

Pax Global Environmental Mrkts Instl	Parnassus Mid-Cap
Morgan Stanley Inst Global Opp	Hartford Schroders Emerging Mkts Eq I
Calvert Emerging Markets Equity I	Amana Growth Investor
RBC Emerging Markets Equity I	Calvert Equity A
AB Sustainable Global Thematic A	TIAA-CREF Social Choice Eq Instl
Amana Income Investor	Parnassus Endeavor Investor
Domini Impact International Equity Inv	JPMorgan Emerging Markets Equity A
Eventide Gilead N	Parnassus Core Equity Investor
Neuberger Berman Socially Rspns Inv	

ESGP Funds

Vanguard FTSE Social Index Inv	iShares MSCI ACWI Low Carbon Target ETF
Calvert US Large Cap Core Rspng Idx I	Calvert Global Water A
iShares MSCI KLD 400 Social ETF	Guggenheim Solar ETF (<i>name change to</i> Invesco Solar ETF)
PowerShares Water Resources ETF (<i>name change to Invesco Water Resources</i>)	Green Century MSCI International Index Fund - Institution
PAX MSCI EAFE ESG Leaders Index Instl	Praxis Growth Index Fund A
iShares MSCI USA ESG Select ETF	Praxis International Index A
Guggenheim S&P Global Water ETF (<i>name change to Invesco S&P Global Water Index ETF</i>)	Praxis Value Index A

Non-ESG Comparison Funds

Morgan Stanley Global Core Portfolio
 iShares Core S&P 500 ETF
 Neuberger Berman Large Cap Value Fund
 TIAA-CREF Growth & Income Fund
 Vanguard Equity Income Fund Investor
 Shares
 Vanguard 500 S&P Index
 JP Morgan Emerging Economies

APPENDIX II

Top 10 Portfolio Holdings of Sample Funds (2018)

*High household name brand recognition denoted by HNB

ESGP SAMPLE (n= 14)		
Vanguard FTSE Social Index Inv. <i>HNB</i>		
Wells Fargo & Co	Cisco Systems Inc	Mastercard Inc A
Procter & Gamble Co	The Home Depot Inc	Walt Disney Co
Intel Corp	Merck & Co Inc	Citigroup Inc
		PepsiCo Inc
Calvert US Large Cap Core Rspn Idx I <i>HNB</i>		
Apple Inc	Amazon. com Inc	Visa Inc Class A
Alphabet Inc A	JPMorgan Chase & Co	AT&T Inc
Microsoft Corp	Bank of America Corp.	Pfizer Inc
		Intel Corp
iShares MSCI KLD 400 Social ETF <i>HNB</i>		
Microsoft Corp	Alphabet Inc A	Intel Corp
Facebook Inc A	Verizon Comm. Inc	Procter & Gamble Co
Alphabet Inc Class C	Cisco Systems Inc	Merck & Co Inc
		Coca-Cola Co
PowerShares Water Resources ETF		
Waters Corp	Xylem Inc/NY	IDEX Corp
Danaher Corp	Toro Co/The	HD Supply Holdings Inc
Roper Technologies Inc	Pentair PLC	AO Smith Corp
		Rexnord Corp
PAX MSCI EAFE ESG Leaders Index Instl <i>HNB</i>		
Roche Holding AG	Commonwealth Bank of Australia	Unilever NV
Dividend Right Cert. ROG	CBA	DR UNA
GlaxoSmithKline PLC GSK	Basf SE BAS	Siemens AG SIE
SAP SE SAP	Novo Nordisk A/S	Allianz SE ALV
	B NOVO B	

iShares MSCI USA ESG Select ETF <i>HNB</i>		
Microsoft	3M	Blackrock
EcoLab Inc	Accenture	Agilent Tech. Inc.
Apple Inc	Alphabet	Northern Trust Cor. Prologis REIT Inc.
Guggenheim S&P Global Water ETF		
Xylem Inc/NY	Geberit AG	Tetra Tech Inc
Danaher Corp	Pentair PLC	Coway Co Ltd
IDEX Corp	Alfa Laval AB	Aalberts Industries NV ANDRITZ AG
iShares MSCI ACWI Low Carbon Target ETF		
Apple Inc.	Johnson & Johnson	JP Morgan
Microsoft	Facebook	Alphabet Inc.
Amazon com Inc	Alphabet Inc. Class A	Pfizer Inc Bank of America Corp.
Calvert Global Water A		
American Water Works Co Inc	United Utilities Group PLC	Suez
Cia de Saneamento de Minas Gerais- COPASA	Guangdong Investment Ltd	Pennon Group PLC
Veolia Environnement SA	Cia de Saneamento do Parana	Beijing Enterprises Water Group Ltd American States Water Co
Guggenheim Solar ETF		
First Solar Inc FSLR	SolarEdge Tech. Inc SEDG	Enphase Energy Inc ENPH
Sunrun Inc RUN	Canadian Solar Inc CSIQ	Hannon Armstrong Sustainable Infrastructure Capital Inc HASI
Scatec Solar ASA SSO	Meyer Burger Technology AG MBTN	SunPower Corp SPWR

Green Century MSCI International Index Fund - Institution		
Kao Corp.	Nintendo Co. Ltd.	RELX PLC
Intesa Sanpaolo S. p. A.	Banco Bilbao Vizcaya Arg. S. A.	Schneider Electric SE
Kering		KDDI Corp.
Canadian Imperial Bank of Comm.		Adidas AG
Praxis Growth Index Fund A <i>HNB</i>		
Apple Inc	Alphabet Inc Class C	UnitedHealth Group Inc
Microsoft Corp	Facebook Inc A	The Home Depot Inc
Amazon. com Inc	Visa Inc Class A	Alphabet Inc A Mastercard Inc A
Praxis International Index A		
Nestle SA	Toyota Motor Corp	HSBC Holdings PLC
Tencent Holdings Ltd	Equinor ASA	Alibaba Group Holding Ltd
Taiwan Semiconductor Manufacturing Co Ltd	Roche Holding AG	Chunghwa Telecom Co Ltd
		AstraZeneca PLC
Praxis Value Index <i>AHNB</i>		
Apple Inc	UnitedHealth Group Inc	Walmart Inc
JPMorgan Chase & Co	AT&T Inc	Citigroup Inc
Bank of America Corp.	Johnson & Johnson	DowDuPont Inc
		Procter & Gamble Co
		Walmart Inc

ESG Fund sample (n=17)		
Parnassus Core Equity Investor <i>HNB</i>		
Xylem Inc	VF Corp	Sysco Corp
WD-40 Co	Verisk Analytics Inc	Synopsys Inc

Waste Management Inc Walt Disney Co	United Parcel Service Inc Class B	Starbucks Corp
JPMorgan Emerging Markets Equity A		
Tencent Holdings Ltd Alibaba Group Holding Ltd ADR AIA Group Ltd Taiwan Semiconductor Manufacturing Co Ltd ADR	Housing Development Finance Corp Ltd Samsung Electronics Co Ltd Ping An Insurance (Group) Co. of China Ltd H	Sberbank of Russia PJSC HDFC Bank Ltd MercadoLibre Inc
Parnassus Endeavor Investor <i>HNB</i>		
Qualcomm Inc Mattel Inc CVS Health Corp Gilead Sciences Inc	Micron Technology Inc United Parcel Service Inc Class B Alliance Data Systems Corp	Allergan PLC Bristol-Myers Squibb Company Hanesbrands Inc
TIAA-CREF Social Choice Eq Instl <i>HNB</i>		
Apple Inc Microsoft Corp Bank of America Corporation The Home Depot Inc	Procter & Gamble Co Cisco Systems Inc Intel Corp	Merck & Co Inc Coca-Cola Co PepsiCo Inc
Calvert Equity A <i>HNB</i>		
Thermo Fisher Scientific Inc Danaher Corp Alphabet Inc Class C Visa Inc Class A	Microsoft Corp Praxair Inc Dollar General Corp	Zoetis Inc Class A Mastercard Inc A Intuit Inc

Amana Growth Investor <i>HNB</i>		
Adobe Systems Inc	Cisco Systems Inc	Alphabet Inc A The Estee Lauder Companies Inc Class A
Apple Inc	Amgen Inc Church & Dwight Co Inc	Harris Corp
Intuit Inc		
TJX Companies Inc		
Hartford Schroders Emerging Mkts Eq I		
Tencent Holdings Ltd	China Construction Bank Corp H	China Petroleum & Chemical Corp H Shares
Samsung Electronics Co Ltd	PJSC Lukoil ADR	AIA Group Ltd
Alibaba Group Holding Ltd	Sberbank of Russia PJSC	Naspers Ltd Class N
Taiwan Semiconductor Manufacturing Co Ltd		
Parnassus Mid-Cap		
Motorola Solutions Inc	Hologic Inc	Clorox Co
Fiserv Inc	Teleflex Inc	Iron Mountain Inc MDU Resources Group Inc
Verisk Analytics Inc	Xylem Inc	
First Horizon National Corp		
Neuberger Berman Socially Rspns Inv <i>HNB</i>		
Progressive Corp	Aptiv PLC	Intercontinental Exchange Inc
Comcast Corp Class A	Danaher Corp	The Kroger Co
Texas Instruments Inc	Becton, Dickinson and Co	Alphabet Inc A
Advance Auto Parts Inc		

Eventide Gilead		
XPO Logistics Inc	Splunk Inc	Macquarie Infrastructure Corp
Wayfair Inc Class A	HubSpot Inc	Instructure Inc
Ascendis Pharma A/S ADR	Palo Alto Networks Inc	Lam Research Corp
Lowe's Companies Inc		
Domini Impact International Equity Inv		
Sanofi SA	Kering SA	Novartis AG
Nissan Motor Co Ltd Central Japan Railway Co	Allianz SE	Koninklijke Ahold Delhaize NV
Vodafone Group PLC	Sandvik AB	AXA SA
Amana Income Investor <i>HNB</i>		
Eli Lilly and Co	Parker Hannifin Corp	Canadian Nat'l Railway Co
Microsoft Corp	Pfizer Inc	DowDuPont Inc
3M Co	Honeywell Internat'l Inc	PPG Industries Inc
Rockwell Automation Inc		
AB Sustainable Global Thematic A		
MSCI Inc	Visa Inc Class A	Infineon Technologies AG
Xylem Inc	UnitedHealth Group Inc	Kingspan Group PLC
Hexcel Corp	Ecolab Inc	American Water Works Co Inc
Housing Development Finance Corp Ltd		
RBC Emerging Markets Equity I		
Naspers Ltd Class N Housing Development Finance Corp Ltd	AIA Group Ltd	Credicorp Ltd
	Unilever PLC	SM Investments Corp

2020]

BUYER BEWARE

2013

Tata Consultancy Services Ltd	Antofagasta PLC	Shinhan Financial Group Co Ltd
Taiwan Semiconductor Manufacturing Co Ltd		
Calvert Emerging Markets Equity I		
Wal – Mart de Mexico SAB de CV Class V	Techtronic Industries Co Ltd	Shoprite Holdings Ltd
Ultrapar Participacoes SA	Tech Mahindra Ltd Taiwan Semiconductor Manufacturing Co Ltd ADR	Shenzhen International Holdings Ltd
Tong Yang Industry Co Ltd		Sberbank of Russia PJSC ADR
Tencent Holdings Ltd		
Morgan Stanley Inst Global Opp <i>HNB</i>		
Amazon.com Inc	DSV A/S	Moncler SpA
Mastercard Inc A	TAL Education Group ADR	Visa Inc Class A
Facebook Inc A	Alphabet Inc C	Hermes International SA
Booking Holdings Inc		
Pax Global Environmental Mrkts Instl		
Sealed Air Corp	Suez SA	Ferguson PLC
Siemens AG	Danaher Corp	Praxair Inc
East Japan Railway Co	Ecolab Inc	Aptiv PLC
TE Connectivity Ltd		

Non-ESG SAMPLE (n= 7)

Morgan Stanley Global Core Portfolio *HNB*

Tencent Holdings Ltd. ADR	Ryanair Holdings PLC ADR	Comcast Corp. Cl A
JPMorgan Chase & Co.	Mastercard Inc.	Booking Holdings Inc.
Apple Inc.	Taiwan Semiconductor Manufacturing Co. Ltd. ADR	VMware Inc.
Nippon Telegraph & Telephone Corp. ADR		
iShares Core S&P 500 ETF <i>HNB</i>		
Apple Inc.	JP Morgan Chase & CO	Alphabet Class A
Microsoft Corp	Berkshire Hathaway Class B	Johnson & Johnson
Amazon Inc.	Alphabet Class C	EXXON Mobil Corp.
Facebook Inc.		
Neuberger Berman Large Cap Value Fund		
American Electric Power Co. Inc.	CME Group Inc. Cl A	Exelon Corp.
Cabot Oil & Gas Corp.	DTE Energy Co.	Exxon Mobil Corp.
Centene Corp.	Equity Residential	First Energy Corp
Chubb Ltd.		
TIAA-CREF Growth & Income Fund <i>HNB</i>		
Abbott Laboratories	Apple Inc.	Chevron Corp.
AbbVie Inc.	Bank of America Corp.	Cisco Systems Inc.
Alphabet Inc. Cl C	Boeing Co.	Citigroup Inc.
Amazon Inc.		
Vanguard Equity Income Fund Investor Shares <i>HNB</i>		
Bristol-Myers Squibb Co.	Coca-Cola Co.	Eli Lilly & Co.
Caterpillar Inc.	Comcast Corp. Cl A	Exxon Mobil Corp.
Chevron Corp.	DowDuPont Inc.	Intel Corp.
Cisco Systems Inc.		
Vanguard 500 S&P Index <i>HNB</i>		
Microsoft Corp	Johnson & Johnson	Facebook Inc A

2020]

BUYER BEWARE

2015

Apple Inc	JPMorgan Chase & Co	Alphabet Inc A
Amazon. com Inc	Alphabet Inc Class C	Exxon Mobil Corp
Berkshire Hathaway Inc B		
JPMorgan Emerging Economies Fund		
Alibaba Group Holding Ltd. ADR	China Merchants Bank Co. Ltd.	Cognizant Technology Solutions Corp.
Baidu Inc. ADR	Chinatrust Financial Holding Co. Ltd.	Fubon Financial Holding Co. Ltd.
Catcher Tech. Co. Ltd.	CNOOC Ltd.	Hana Financial Group Inc.
China Const. Bank Corp.		

APPENDIX III

2018 Voting Records Snapshot

Sample Group	Fund	Fund Votes		
		Climate Change	Gender Pay/ Diversity	Political Spending ²⁶³
Passive ESG	Vanguard FTSE Social Index	1 against	5 against	17 against
	Calvert US Large Cap Core Resp Index I	4 against	5 for	16 for
	iShares MSCI KLD 400 Social ETF	1 for	9 for	11 for
	PowerShares Water Resources ETF ²⁶⁴	0 proposals	0 proposals	0 proposals
	PAX MSCI EAFE ESG Leaders Index Instl	3 for	8 for	12 for
	iShares MSCI USA ESG Select ETF	1 for	9 for	11 for
	Guggenheim S&P Global Water	0 proposals	2 for	1 for
	iShares MSCI ACWI Low Carbon Target ETF	split, 1-1 ²⁶⁵	split, 11-1	17 for
	Calvert Global Water A	0 proposals	1 for	3 for
Guggenheim Solar ETF	0 proposals	split, 11-1	0 proposals	

²⁶³ Many of the funds in our sample voted on management proposals to authorize political spending, per European regulations. As these were not shareholder proposals, we do not report votes on them in Table 4.

²⁶⁴ Several funds in our sample faced no relevant votes on our selected ESG issues during our sample period. Indeed, some faced no ESG-related proposals at all. Funds without reportable votes were primarily those dedicated to emerging market companies.

²⁶⁵ Split votes are reported in the format for-against unless the fund abstained, in which case votes are reported in the format for-against-abstention.

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	Green Century MSCI International Index Fund - Institution	0 proposals	9 for	0 proposals
	Praxis Growth Index Fund	0 proposals	6 for	12 for
	Praxis International Index	2 against	0 proposals	0 proposals
	Praxis Value Index	1 for	6 for	9 for
ESG	Pax Global Environmental Markets Instl	3 for	9 for	7 for
	Morgan Stanley Inst Global Opp I	0 proposals	0 proposals	0 proposals
	Calvert Emerging Markets Equity I	0 proposals	0 proposals	0 proposals
	RBC Emerging Markets Equity I	0 proposals	0 proposals	0 proposals
	AB Sustainable Global Thematic A	0 proposals	1 for	3 for
	Amana Income Investor	0 proposals	0 proposals	split 4-1 ²⁶⁶
	Domini Impact International Equity Inv	0 proposals	5 for	3 for
	Eventide Gilead N	0 proposals	2 for	0 proposals
	Neuberger Berman Socially Rspns Inv	1 for	1 for	3 for
	Parnassus Mid-Cap	0 proposals	8 for	2 for
	Hartford Schroders Emerging Mkts Eq I	2 against	split 2-1-4	5 against
	Amana Growth Investor	0 proposals	split, 1-1	2 for
	Calvert Equity A	2 for	0 proposals	2 for
	TIAA-CREF Social Choice Eq Instl ²⁶⁷	0 proposals	0 proposals	0 proposals

²⁶⁶ The negative vote opposed a proposal to require cost-benefit analysis of political spending.

²⁶⁷ Votes for TIAA-CREF Social Choice Eq Instl do not appear in the relevant N-PX report.

	Parnassus Endeavor Investor	0 proposals	3 for	1 for
	JPMorgan Emerging Markets Equity A	0 proposals	0 proposals	0 proposals
	Parnassus Core Equity Investor	0 proposals	5 for	1 for
Non-ESG	Morgan Stanley Global Core Portfolio	0 proposals	split 1-2	4 for
	iShares Core S&P 500 ETF	10 against	split 2-7	14 against
	Neuberger Berman Large Cap Value Fund	1 for	split 6-2	split 2-2
	TIAA-CREF Growth & Income Fund	0 proposals	1 for	split 2-3-5
	Vanguard Equity Income Fund Investor Shares	0 proposals	split 8-3	18 against
	JP Morgan Emerging Markets	0 proposals	0 proposals	0 proposals