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ESG Investing: No Noise, No Greenwashing—Just the Facts

Depending on where you get your news, you might see a lot of political chatter about ESG being part of the “woke” agenda. In some states, officials complain that ESG-focused investment funds are violating their core fiduciary duty, using the assets of state pension funds to push Paris Agreement goals and force the phase-out of fossil fuels.

I see things very differently, and so does Andrew Rabinowitz, Co-CEO of K2 Integrity. We believe fundamentally in the notion that funds should work for their investors’ long term interests. But we also believe a fund manager’s paramount duty is to gain the clearest possible view on an investment’s long-term strength. ESG has the potential to provide that view—and we at K2 Integrity have a new solution that assures ESG can rise to that potential.

ESG: Rhetorical Shorthand or Useful Acronym?

The broad consensus holds that a company’s success is built on good governance, the ability to recruit and retain top talent to drive innovation, and strategies that promote efficiency and resilience—all of which position the enterprise to thrive into the future.

That’s ESG: environment, social, and governance, a useful if sometimes incomplete and contentious catch-all for measuring investments in a changing environment.

“ESG is a lens that helps you see any investment more clearly,” says Joseph Naayem, founding partner at sustainable finance advisory firm Kalmus Capital. While it’s sometimes cited in simplistic “good vs. bad” arguments that can ignore real-world context (e.g., pro or con positions on cutting fossil fuel investments before solidifying renewables infrastructure), ESG investment should remain focused on credible, long-term value creation. “ESG enables pension funds to better assess and shape how companies steer their evolution, such that they remain fit for purpose in ten, twenty, thirty years,” says Naayem. “Given their long-term liabilities, pension funds are not fulfilling their fiduciary duty if they only focus on compounding short-term profits at the expense of broader stakeholders and the environment that allows these profits to be generated in the first place.”

Institutional investors increasingly agree. In a recent study from PwC, three quarters of respondents agreed that ESG is now part of their fiduciary duty, and 72% set ESG-related goals for their asset managers at the portfolio level.

With the toll from rising temperatures, extreme weather, habitat loss, and other climate-related impacts clarifying the world's challenges, the value of long-term planning around ESG themes has become increasingly clear. But the required scale and pace of change is unprecedented in human history, fueling uncertainty.

"What we have right now is muddy water," says Todd Cort, Co-Director at the Yale Center for Business and the Environment. "There have been 10,000-plus empirical studies trying to test the relationship between ESG and financial performance, and the answer appears to be: it depends. So people are looking at this and putting their own label on it: 'muddy water is bad' or 'muddy water is good.' We need to be able to see through that water more clearly. We need to be able to separate out whether a fund is using ESG information to maximize profits, balancing environmental and social impact against financial performance, or just greenwashing."

A Solution to Assure Investor Trust

In a changing world, most asset managers are eager to leverage ESG to show they're doing the right thing, both for the planet and for their investors' long-term interests. But how do investors know those managers are doing the right thing the right way?

That's the question that motivated K2 Integrity to develop our new **Integrity 2 ESG certification,** which leverages the firm's deep investigations, regulatory, risk, controls, ESG, and industry expertise to offer funds and fund managers independent certification of their ESG strategies.

"There's a large market failure in this area,' says Shivaram Rajgopal, Kester and Byrnes Professor of Accounting at Columbia Business School. "Consumers buy the ESG label from funds but do not have the time or the means to verify whether the fund lives up to that label. Good funds want to assure consumers of their quality. Hence, we need a trusted intermediary like K2 to make this market and reduce information asymmetries between the buyer and the high-quality ESG seller."

With both investors and regulators carefully scrutinizing ESG claims, and with the methods and metrics for measuring ESG evolving rapidly, our new solution uses a risk-based approach to holistically assess a fund's ESG stance across five pillars:

1. **Commitment to ESG Priorities.** Evaluates commitments the firm has made to corporate social responsibility, and its transparency with stakeholders. Investigations associated with this pillar validate legal, regulatory, and tax compliance and assess ESG integration into organizational and risk strategies.

2. Management & Accountability. Evaluates ESG oversight and accountability at the firm, including policies, procedures, internal controls, and adherence to good governance principles.

3. External Communication. Reviews the consistency and clarity of all external communications around ESG commitments and objectives.

4. Integrity of the Investment Process. Evaluates how consistently the investment process adheres to ESG representations and commitments, and the extent to which it meets recognized standards of care.

5. Metrics. Assesses the ESG metrics used in internal and external reporting, evaluating consistency, relevance, and completeness.

The output is a clear, comprehensive, and unbiased view into the integrity of a fund's ESG claims, offering investors comfort that they can trust fund managers to invest wisely along their long-term incentive structure.

"With this certification, we're not advocating what is the right thing to do," says Kalmus's Joseph Naayem, who was integral to its development. "Instead, we're validating that funds know what the right thing to do is, and that they can be trusted when making the necessary disclosures so pension funds can decide for themselves."

"Over time," says Shivaram Rajgopal, "thanks to K2 Integrity's certification and other measures that ESG funds can take to credibly bond themselves to higher standards, greenwashers will get flushed out."

In an evolving landscape, our certification begins with the ESG disclosure obligations imposed by the EU's Sustainable Finance Disclosure Regulation (SFDR), then applies a proprietary framework, methodology, and scoring rubric to gauge the real-world efficacy of companies' ESG strategies, policies, and practices. The result helps funds navigate ambiguities in ESG regulatory requirements and validates that firms and funds are following through on their ESG claims—giving pension fund managers and other investors actionable insight into future performance and returns.