“Inside the ESG Ratings: (Dis)agreement and performance”

Monica Billio, Ca' Foscari University of Venice,

with Michele Costola, Ca' Foscari University of Venice,
Iva Hristova, Université Paris Dauphine,
Carmelo Latino, Leibniz Institute for Financial Research SAFE
and Loriana Pelizzon, Goethe University Frankfurt

Discussant: Álvaro González, Central Bank of Chile

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This paper relate two areas of investigation about the development and use of ESG Ratings

Disagreement of the ESG rating scores available, and Economic and financial performance of ESG portfolios.

- Therefore, it investigates the implications that ESG rating disagreement might have on ESG portfolio performance.

- The authors analyze and conclude:
  - **ESG rating criteria analysis** → There is a lack of common standards.
  - **Heterogeneity of ESG standards** → Generates different evaluations for the same companies.
  - **Small overlap of constituents** → Disperses the effects of preferences of ESG investors → There is no (significant) ESG impact on performance.

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The document revises three aspects of the ESG rating literature and concludes that harmonization is needed

- (Positive) impact of ESG efforts on companies' profitability.
- Performance (gain) on ESG firms/portfolio investments.
- (Positive) Effects of ESG factors on credit ratings.

  ➢ Above results are dependent on the ESG data/rating/evaluation/accounting

- Are the results dependent on the ESG rating only?
- Is profitability/return the best way to account or measure the ESG performance?
- Is it possible to have good and consistent ESG ratings if we don't have first a consistent and accepted ESG taxonomy?

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ESG ratings differ from each other affecting the constitution of ESG investment portfolios

- ESG ratings methodology (i.e. weights, variables) are different.
- Companies’s ESG rating evaluation strongly varies across rating agency and the correlation is low.
- Percentage of “agreement” among ESG ratings is low, which affects the consistency of ESG indexes and portfolios.

- Is there a ESG rating that outperform the rest?
- Are the internal correlations among E, S and G important?
- Is it possible that the agreement indicator is capturing underlying non-observable variables?

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The ESG index agreement among ESG ratings do not significantly affects the portfolio performance

- Compares the financial performance of an ESG Agreement portfolio vis a vis a non-ESG portfolio, using the Jensen-alpha measure (Carhart four-factor model).
- Analyzes two periods: 2000-2004 and 2005-2020.
- Built long (ESG)/short (non-ESG) positions to evaluate the performance of that strategy.
  - ➢ The ESG effects are diluted without impacting on the performances. This result is a consequence of the disagreement among rating agencies.

- Is the year 2005 an exogenous division of the sample?
- Why the non-outperforming of an ESG agreement portfolio is a consequence of the disagreement of the ESG ratings? Is there space for other explanations?
- Given the particular aspects of ESG components, are the traditional asset pricing specifications suitable for their portfolio valuations?

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