RISK GOVERNANCE FOR ENVIRONMENTAL, SOCIAL, AND GOVERNANCE INVESTING AND ACTIVITIES

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Abstract

This paper addresses the critical need for effective risk governance in environmental, social, and governance (ESG) investing and activities. Recognizing a gap in the existing literature, the research aims to propose strategies for asset managers, investors, corporate executives, and boards of directors to assess and enhance risk governance practices. Utilizing Fink's (2021) letter to chief executive officers (CEOs) as a foundational checklist, the study emphasizes the importance of aligning business models with net-zero economy goals and integrating these into long-term strategic planning. Through a comprehensive review of current practices, challenges, and the concept of greenwashing and greenhushing, the paper provides a detailed analysis of how stakeholders can differentiate between genuine ESG commitments and superficial ones. The main findings highlight the necessity for robust monitoring mechanisms and transparent disclosures to ensure alignment with shareholder and stakeholder value. The conclusions underscore the need for ongoing research and practical applications, particularly through case studies and empirical analyses, to validate the proposed strategies. This paper is relevant to various stakeholders committed to sustainable and responsible investing, offering a pathway to more credible and effective ESG practices.

Keywords: Risk Governance, ESG Investing, ESG Activities

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1. INTRODUCTION

Climate Action 100+ (CA100+), the world's largest investor group focused on climate change, is intensifying its efforts to ensure companies transform their emission-reduction promises into tangible actions. Established in 2017, this coalition consists of over 700 investors collectively managing $68 trillion in assets. These investors are dedicated to managing climate risks and safeguarding shareholder value. CA100+ is an investor-driven initiative aimed at ensuring the world's largest corporate greenhouse gas (GHG) emitters take the necessary steps to address climate change. The initiative's first phase concentrated on enhancing corporate governance, reducing emissions, and improving climate-related financial disclosures. In its second phase, from 2024 to 2030, the strategy has evolved to push companies to translate their emission-reduction pledges into concrete actions by

executing transition plans to cut GHG emissions — moving from words to deeds. Francois Humbert, chair of the CA100+ steering committee, stated: "We really need to create knowledge to go from the what to the how" (Marsh, 2023, para. 3).

Despite these efforts, there is a significant literature gap concerning the risk governance of environmental, social, and governance (ESG) investing and activities. Most current research has concentrated on various aspects of ESG metrics, the financial effects of corporate social responsibility (CSR), and theoretical models of corporate governance in sustainability (Grove et al., 2023a). However, there is limited research addressing the practical aspects of risk governance in ESG investing, particularly in distinguishing genuine ESG commitments from greenwashing and greenhushing.

This paper seeks to address this gap by offering strategies for asset managers, investors, corporate executives, and boards of directors to more effectively evaluate and improve risk governance practices. These stakeholders can also play a critical role in determining whether ESG investments and activities align with and deliver value to shareholders, customers, employees, communities, and other stakeholders. The core research question explored is:

RQ: How can these various stakeholders effectively oversee and facilitate risk governance in ESG investments and activities to ensure alignment with long-term strategic objectives and stakeholder value?

The theoretical framework applied in this study is based on Larry Fink's 2021 letter to chief executive officers (CEOs), which outlines key strategic points for aligning business models with a net-zero economy (Fink, 2021). This framework serves as a foundational checklist for evaluating ESG commitments and activities. The research methodology involves a detailed literature review, case studies, and empirical analyses to validate the proposed strategies. The main findings highlight the necessity for robust monitoring mechanisms and transparent disclosures, demonstrating how stakeholders can differentiate between genuine ESG commitments and superficial ones.

The relevance and significance of this study lie in its potential to provide practical guidance for stakeholders involved in ESG investing. By offering a comprehensive review of current practices and challenges, and by addressing the issues of greenwashing and greenhushing, this paper contributes valuable insights into effective risk governance strategies. Future research could build on these strategies with additional case studies or empirical studies to further validate their relevance and value.

This paper offers a pathway to more credible and effective ESG practices, aligning with the long-term interests of shareholders, customers, employees, communities, and other stakeholders.

The structure of this paper is as follows. Section 2 provides the background of CA100+ and reviews the relevant literature. Section 3 presents the research methodology. Section 4 discusses risk avoidance strategies, including greenhushing and greenwashing. Section 5 addresses the Scope 3 conundrum. Finally, Section 6 presents the conclusions.

2. LITERATURE REVIEW AND RESEARCH BACKGROUND

2.1. Background of Climate Action 100+

CA100+ engages with over 600 companies. So far 75% of the investor group's target companies have set net zero commitments, 90% are publishing information aligned with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), and 33% have a strategy aligned with the 1.5C Paris Climate Agreement. In its second phase, CA100+ will focus on encouraging companies to cut emissions across supply chains, implement transition plans, and articulate boards of directors' oversight of climate risk. The main thrust of the CA100+ approach is engagement. Instead of divesting from dirty companies, asset managers should try to persuade them to decarbonize.

In the first five years of CA100+, carbon emissions have continued to rise, and some large company emitters have lost their appetite for cutting emissions amid higher energy prices. ESG Book, a provider of sustainability data, published research in June 2023 that confirmed the world's largest companies have made limited progress over the past five years. Of the world's biggest 500 companies, only 18% were aligned with the 1.5C Paris Climate Agreement in 2018 which improved to 22% in 2023, despite global emissions reeding to fall by 42% by 2030. In the Europen Union (EU), 25% of large and mega-cap companies were 1.5C aligned in 2023, a small increase from 24% in 2018. In the U.S.A., 20% of the largest companies were aligned in 2023, compared to 11% in 2018. In China, the share of the largest companies on the 1.5C path increased to 12% from 3% over the same period (Marsh, 2023).

Analysts at Bloomberg New Energy Finance (NEF) estimate that an annual investment and expenditure of $4.8 trillion is needed through the end of the decade to meet the environmental 1.5C target set by the Paris Climate Agreement. This figure is significantly higher than the $1.8 trillion allocated last year. The energy industry is diverse, and there is no one-size-fits-all strategy for navigating clean energy transitions. Attention often focuses on the oil majors, seven large integrated oil and gas companies that have an outsized influence on the industry practices and direction. However, the oil and gas industry is much larger. The majors account for only 12% of oil and gas reserves, 15% of production, 17% of investment, and 10% of estimated emissions from industry operations per the International Energy Agency (IEA), which issued a World Energy Outlook special report in 2020. National oil companies (NOCs), fully or majority-owned by national governments, and international NOCs (INOCs) account for well over half of both global production and global reserves. Thus, this annual $4.8 trillion investment and spending target should be focused on these NOCs.

Citing this new second phase of CA100+, in February 2024, the following huge asset manager companies (with their assets under management) withdrew from CA100+: BlackRock ($9.4 trillion), State Street Global Advisors ($4.1 trillion), and JPMorgan Asset Management ($3.1 trillion). BlackRock, the world's largest asset manager, announced that

it will transfer its membership to BlackRock International, citing that most of its clients seeking investment solutions for climate, energy transition, and decarbonization are located outside the U.S.A. Additionally, the new CA100+ strategy could introduce legal challenges, particularly in the U.S.A. State Street expressed that the latest CA100+ requirements conflict with its independent approach to proxy voting and managing portfolio companies. JPMorgan explained that it exited the CA100+ group due to its substantial investments in developing its own climate risk engagement framework.

Stephanie Pfeifer, CEO of the Institutional Investor Group on Climate Change and a member of the global Steering Committee, stated: "Climate Action 100+ has been transformative for corporate engagement and the role of investors in the context of climate change. However, there is no hiding from the fact that overall focus companies need to be more action-oriented if they are to support and capitalise on the transition of the global economy" (Segal, 2023, para. 5).

Lucie Pinson, executive director of the non-profit Reclaim Finance, stated that the motivations of major financial institutions may not align with global climate objectives. She warned that regulation might be the next step, as the absence of regulatory measures could lead to severe financial risks for the global economy and unbearable consequences for millions of people directly affected by climate change (Marsh, 2024a).

These significant departures are happening amid a growing political backlash in the U.S.A. against ESG investing strategies. This backlash has been intensifying since 2021 when Texas became one of the first states to enact laws limiting state government contracts with companies perceived to take punitive actions against the fossil fuel industry. Republican officials across the country have initiated investigations into banks and asset managers, proposed anti-ESG legislation, and withdrawn funds from firms like BlackRock, which has been a prominent advocate of sustainable investing.

United States House Committee on the Judiciary's chairman Jim Jordan, who sought a pardon from then President Trump after the January 6 insurrection, and an Ohio Republican, called the decisions by State Street and JPMorgan big wins and hoped "more financial institutions would follow suit in abandoning collusive ESG actions" (Jordan, 2024). He has called CA100+ an "ESG cartel". Lance Dial, a partner at law firm K&L Gates, said: "I wouldn't be surprised if we see more defections, especially given that there's now a cost, such as potential litigation, that wasn't there when companies joined. […] Attorneys general in various US states have subpoenaed firms about their membership of these groups" (Marsh et al., 2024b, para. 4).

However, Michael Sherern, a former senior advisor at the Bank of England and now a fellow at the Cambridge Institute for Sustainability Leadership, said that JPMorgan's "decision to quit is indicative of a political environment that's ignoring the grave future risks posed by a warming planet. […] The political winds aren't rewarding climate-active firms today, but climate risk and regulations aren't going away in the mid to long run, so short-term decisions may need to be undone when those longer-term threats begin to manifest, or regulators clamp down harder. […] JPMorgan pulling out matters because it sends the wrong, short-sighted signal and gives cover for others to do the same" (Marsh, 2024b, paras. 8–9).

2.2. Literature review

Agbata et al. (2022) reviewed the impact of corporate governance on sustainability in Nigerian firms from 2012 to 2022, finding significant effects on environmental sustainability but mixed effects on social and financial sustainability. Velte (2022) summarized archival research on corporate governance and its financial impact on CSR performance, concluding that effective governance should enhance CSR reporting and outcomes. Mamun (2022) used regression analysis to demonstrate a connection between CSR reports and company performance, noting that economic and social performance disclosures significantly influence outcomes. Boffo and Patalano (2022) provided a comprehensive analysis of current ESG investing practices, progress, and challenges, highlighting key factors influencing implementation and effectiveness.

Grove et al. (2023) underscored the importance of strategic foresight, offering guidance on how to effectively implement it. Strategic foresight is defined by three key types of thinking — future, system, and exponential — and includes crucial elements like horizon scanning and scenario planning. As CEOs express concerns over their companies' future resilience, adaptability to industry shifts, and risk governance, strategic foresight emerges as a critical capability. Its structured, yet flexible approach helps identify and navigate emerging challenges and opportunities, enhancing decision-making in uncertain environments. By fostering foresight, companies can better manage emerging trends, uncertainties, risks, and opportunities, leading to sustainable growth. Therefore, it is essential for asset managers, investors, corporate leaders, boards, and other stakeholders to recognize the strategic value of foresight for effective risk management and governance.

Sheehan et al. (2023) explore how corporate boards are evolving their risk management approaches to better oversee and address the increasingly significant and complex nature of ESG risks. A global survey conducted by Soonieus et al. (2023), involving 879 participants from over 25 countries across 19 industries, provided deep insights into board perspectives on various ESG-related issues. The survey highlighted the impact of sustainability initiatives on board functions, showing how boards are adjusting their structure, governance, and processes to align with sustainability objectives and stakeholder expectations, with varying degrees of success (Soonieus et al., 2023).

Peloso and Schmergel (2022) examined the influence of the evolving ESG landscape on corporate governance, particularly in terms of board oversight and disclosure requirements. They highlighted the challenges boards face in adapting to these changes, emphasizing the need for enhanced expertise and strategic focus in ESG-related areas. Grove et al. (2022) focused on the challenges boards face in managing, assessing, and tracking ESG performance. Before the EU's ESG requirements for publicly listed companies in Europe, there were no

standardized ESG measures, leading to difficulties in comparisons and analyses for boards, management, and stakeholders. The paper advocated for a measurement theory perspective, emphasizing the need for valid, reliable, and operational measurement techniques to apply and assess ESG metrics. Should ESG measures become mandated by national securities regulators, like the new European ESG listing requirements, boards would have specific benchmarks, targets, and reports to manage ESG pledges and performance effectively.

Professor Bob Garatt, Director at Good Governance Development Ltd., recommended a critical research paper titled "Climate scientists: concept of net zero is a dangerous trap", authored by three UK environmental science professors (Dyke et al., 2021). With extensive experience in climate change, these scientists critique the prevailing belief that technological solutions, like mass tree planting and direct air capture, combined with fossil fuel reductions, will quickly achieve net zero by 2050. They argue that this reliance on technology diminishes the urgency for immediate emissions cuts, fostering a "burn now, pay later" mentality that could lead to continued carbon emissions (Dyke et al., 2021).

Raghunandan and Rajgopal (2023) conducted an empirical study on Business Roundtable (BRT) companies that signed the stakeholder-focused Statement on the Purpose of a Corporation in August 2019. They examined whether these signatory firms exhibited better environmental and employee practices compared to non-signatories within the same industries. The findings revealed higher rates of environmental and labor violations among signatory firms, as well as higher carbon emissions, suggesting possible greenwashing with implicit board approval.

Grove and Clouse (2021) investigated the responsibilities of corporate boards regarding renewable energy commitments, particularly in response to activist investor pressure. As more companies commit to renewable energy, it falls on boards to ensure these commitments are met as part of enhanced corporate governance. The study examined whether boards are actively monitoring these commitments or simply engaging in greenwashing by making promises without substantial follow-through. Longo and Tenuta (2020) evaluated sustainability across environmental, economic, and socio-institutional dimensions using the triple-bottom-line approach and created a Sustainable Irrigation Index to monitor irrigation practices. An empirical study by Hayami et al. (2015) explored the relationship between environmental and economic performance in manufacturing supply chains in Japan, finding that companies with suppliers who produced less waste and GHG emissions performed better economically.

Mari et al. (2019) examined the influence of religiosity on ESG disclosure at a cross-country level, finding that religiosity can enhance ESG disclosure. Saviano et al. (2019) used the sustainability helix model to analyze ESG disclosures among Italian-listed companies, emphasizing the importance of open dialogue and collaboration in raising sustainability awareness. Shima et al. (2019) showed that voluntary disclosure by firms is positively correlated with improved environmental performance following regulatory changes. Fatemi et al. (2018) found that ESG disclosures can mitigate the negative impacts of firm weaknesses while amplifying strengths.

The existing literature largely focuses on various aspects of ESG measures, the financial impacts of CSR, and theoretical frameworks for corporate governance in sustainability. Previous studies show how corporate boards are adapting strategies to manage ESG risks, highlighting the importance of aligning board activities with sustainability goals. They underscore the necessity of strategic foresight and structured approaches to address emerging challenges, viewing foresight as vital for risk management and governance. The literature also explores the evolving ESG landscape and the challenges boards face in adapting to new disclosure requirements, advocating for robust measurement techniques to assess ESG performance. Empirical evidence on corporate governance's impact on sustainability presents mixed results, indicating nuanced effects on financial and social sustainability. Some studies suggest that ESG disclosures can mitigate negative firm attributes and enhance strengths, while others warn of greenwashing, noting higher environmental and labor violations among firms with stakeholder-focused commitments.

This literature review identifies a significant gap in research on the risk governance of ESG investing and activities. This paper contributes to the field by examining and proposing methods for asset managers, investors, company executives, and boards of directors to effectively oversee and facilitate risk governance in ESG investing and activities. Through a detailed analysis, it bridges the gap between theoretical understanding and practical application, offering valuable insights into risk governance for these stakeholders.

3. RESEARCH METHODOLOGY

This section outlines the methods applied during the research and describes alternative methods suitable for conducting similar research. The primary methodology used in this study includes a comprehensive literature review, real-world examples, and content analysis. These methods were chosen to provide a detailed understanding of risk governance in ESG investing and to offer practical guidance for stakeholders.

First, a thorough literature review was conducted to identify existing research gaps and gather relevant theoretical frameworks. This involved analyzing academic journals, industry reports, and regulatory documents related to ESG investing, risk governance, greenwashing, and greenhushing. The literature review helped in framing the research question and in identifying key concepts and variables for the study.

Second, several real-world examples of effective and ineffective risk governance were provided to illustrate how companies implement ESG strategies, the challenges they face, and the outcomes of their efforts. This method allowed for an in-depth analysis of specific instances of ESG investing and risk governance, providing practical insights and lessons learned.

Lastly, the paper analyzes and synthesizes corporate reports, press releases, and other

public documents to understand how companies communicate their ESG commitments and practices. This method is useful in identifying patterns of greenwashing and greenhushing.

Several alternative methods could also be suitable for conducting similar research on risk governance in ESG investing, including surveys and interviews, empirical analyses, experimental studies, and comparative studies. Future research can employ these methods to provide a comprehensive and robust analysis of risk governance in ESG investing, offering practical recommendations for stakeholders to enhance their practices and achieve their sustainability goals.

Conducting surveys and interviews with asset managers, investors, corporate executives, and board members could provide valuable qualitative data. This approach would offer insights into the perspectives and experiences of stakeholders directly involved in ESG investing and risk governance.

Conducting empirical analyses using data from financial reports, ESG ratings, and other relevant sources, and employing statistical methods such as regression analysis, can examine the relationship between ESG practices and financial performance, risk management effectiveness, and stakeholder value. This approach can provide quantitative evidence to support the findings and recommendations related to risk governance in ESG investing.

Designing experiments to test the effectiveness of different risk governance strategies in controlled settings could provide causal evidence. This approach would help in understanding the impact of specific interventions on ESG performance and risk management.

Conducting comparative studies of different industries, regions, or regulatory environments could reveal how various factors influence ESG investing and risk governance. This method would be useful in identifying best practices and areas for improvement.

4. RISK AVOIDANCE: GREENHUSHING AND GREENWASHING

Due to anti-ESG campaigns, many fund managers and companies that once proudly aligned their portfolios and corporate goals with net-zero emissions and highlighted their environmental achievements are now downplaying or concealing these efforts, a practice known as greenhushing. Additionally, membership in climate finance groups and net-zero pledges, which were once celebrated and prominently featured in press releases and company reports, have become liabilities. Progress in reducing emissions among major polluters has stalled amid an energy crisis, largely driven by Russia's war against Ukraine and diminishing political commitment to climate policies. Moreover, the focus of countries and politicians has shifted from reducing fossil fuel use to prioritizing energy security. Mark Campanale, founder of the energy transition research firm Carbon Tracker, remarked: "The anti-ESG lobby has instilled fear in investors. While they will continue to integrate sustainability due to the genuine risks, they will do so discreetly, avoiding publicizing large initiatives that attract unwanted attention. What we're witnessing now is greenhushing" (Marsh, 2024a, para. 4).

Recent developments have introduced additional challenges for investors and companies, many of whom are now striving to keep a lower profile on climate actions. This has led to strategies aimed at risk avoidance, such as greenhushing or greenwashing. As numerous companies make net-zero pledges or commitments, it becomes imperative for asset managers, investors, and boards of directors to closely monitor these commitments to ensure robust risk management and corporate governance (Henisz et al., 2019). For instance, one study expanded the concept of corporate governance by examining board responsibilities in light of recent trends in renewable energy. The study's primary research question focused on whether boards of directors are effectively overseeing their companies' commitments to renewable energy and whether they are genuinely pursuing significant efforts or merely engaging in greenwashing — making commitments without meaningful follow-through (Grove & Clouse, 2021). That research paper concluded by recommending that boards follow BlackRock CEO Larry Fink's guidance. An excellent starting point for monitoring ESG investing and activities by asset managers, investors, corporate executives, and boards of directors would be to use the key strategic points outlined in Fink's 2021 letter to CEOs all public company CEOs: "We are asking companies to disclose a plan for how their business model will be compatible with a net zero economy […and] how this plan is incorporated into your long-term strategy and reviewed by your board of directors" (Fink, 2021, para. 20). The four CEO strategic climate points are summarized here as a checklist (Fink, 2021):

- Report in alignment with the recommendations of the TCFD. Set rigorous short, medium, and long-term targets to reduce emissions.
- Disclose how your business plan is compatible with transitioning to a net-zero economy and how it is incorporated into your long-term strategy and reviewed by your board of directors.
- Monitor if sustainability and deeper connections to stakeholders are driving better returns. Monitor if your company is showing its purpose in delivering value to its stakeholders: customers, employees, and communities. Monitor how successfully your company is competing and delivering long-term durable profits for shareholders.
- We expect directors to have sufficient fluency in climate risk and the energy transition to enable the whole board — rather than a single director who is a "climate expert" — to provide appropriate oversight of the company's plan and targets.

These four CEO strategic climate points enable various stakeholders to evaluate whether companies are genuinely committed to ESG investing and activities or are engaging in greenhushing — where asset managers and companies that previously committed to aligning their portfolios and corporate goals with net zero emissions, and once proudly promoted their green credentials, are now downplaying or concealing them — or greenwashing, where they make commitments or pledges without any significant follow-through.

As more companies increasingly attempt to keep their climate pledges out of the public eye, greenhushing has become widespread, even as some businesses set more ambitious internal targets. South Pole, a climate consultancy firm, conducted its

third annual review of corporate attitudes toward net zero. The survey included 1,200 large companies from 12 different countries, all of which have set net-zero targets, with over two-thirds identified as "heavy emitters". Although most of these companies have established science-based targets to fulfil their commitments, 23% have no plans to make them public.

The South Pole findings indicated that the fear of being accused of greenwashing is so strong that executives are willing to go to great lengths to avoid it. The label of greenwashing carries significant reputational harm, financial loss, and heightened regulatory attention. Once a company is marked by such accusations, it can face considerable challenges in restoring its reputation (Marsh, 2022). A current seven-point analysis of greenwashing by Bloomberg Green can be used by asset managers, investors, corporate executives, boards of directors, and other stakeholders to assess ESG investing and activities as follows (Poh, 2023):

• *What is greenwashing?* It's the use of misleading labels or advertising to create an undeserved image of environmental responsibility. Examples include the UK's antitrust regulator investigating Unilever for allegedly overstating the environmental qualities of certain products. Air France and Lufthansa were told by regulators to discontinue misleading ads that made air travel seem more eco-friendly than it is. In the U.S.A., Deutsche Bank's asset management group agreed to pay $25 million to settle Securities and Exchange Commission (SEC) probes into alleged greenwashing and anti-money laundering lapses.

• *What's the incentive for greenwashing?* The ultimate attraction is the favorable image companies project across to clients, investors, shareholders, lenders, and even potential employees. When companies greenwash their products, they want to attract environmentally-minded consumers. When companies are borrowing money, they may be chasing a "greenium", the money they can save by qualifying for the better terms lenders might extend to green projects or to ones with ESG goals, or a "fraudium" on financial statements to save interest expenses.

• *How big a problem is it?* In 2022, Bloomberg News analyzed more than 100 bonds worth $70 billion tied to issuers' ESG credentials that were sold by global companies to investors in Europe. The analysis found that the majority were tied to climate targets that were weak, irrelevant, or even already achieved.

• *How does sustainability-linked debt work?* They are aligned with commitments from borrowers to achieve certain environmental or social targets. The more flexible agreements even allow issuers to adjust those targets under certain conditions without incurring a penalty. Then there is the "sleeping" sustainability-linked debt where financing has an ESG label but with no immediate sustainability targets.

• *Who's checking up?* There are dozens of ESG rating and data providers globally, but private rating systems can be unreliable and corporate reporting is spotty and hard to compare. The EU now has required ESG reporting for its publicly listed companies. In the U.S.A., the SEC is working on getting companies to report on their GHG emissions and other climate matters but is facing strong political opposition.

• *Is it just environmental misconduct that's considered greenwashing?* No, social and governance aspects have grown to be just as crucial as companies' environmental efforts, especially since the #MeToo, #BlackLivesMatter, and various abortion movements began making an impact on consumers' spending. Given that goals like equality of employment and employee well-being improvement are hard to measure, there is a risk of overstating the results.

• *How can I avoid investing in greenwashing?* Here are some questions the various stakeholders can ask:

a) How ambitious are a company's goals? Are they integral to its core business, or just superficial commitments? Is the company just promising to do something it would be doing anyway?

b) How specific is the timeframe? Are the goals set annually, or in a way that allows for easy monitoring?

c) Are companies looking at the full scope of their emissions, including the carbon released when customers use their products?

d) How much do their plans rely on the kinds of carbon "offsets" that have come under fire for not living up to their promises of environmental benefits?

e) Is there a way to check on companies' claims, such as in an evaluation by an impartial ESG data or ratings provider?

f) Is the company making information about its sustainability goals accessible in a transparent and timely way?

5. SCOPE 3 CONUNDRUM

Part C of the seventh question above addresses the Scope 3 conundrum: Are companies looking at the full scope of their emissions, including the carbon released, when customers and supply chains use their products? This issue has led to a pause in the complete implementation of the mandatory European ESG reporting requirements for its public companies, concerning Scope 3 emissions, although the fundamental requirements must be reported on, starting in June 2024. This challenging issue contributed to the COP28 United Nations (UN) Climate Conference's decision to just transition away from, but not replace, fossil fuels. Fossil fuel companies, especially Big Oil, were adamant in opposing Scope 3 reporting for their customers and supply chains.

When asset managers initially pledged to align their portfolios with net zero emissions, they largely avoided addressing the complex issue of Scope 3 emissions. However, a few years later, this is no longer feasible. Beyond the EU's Scope 3 reporting challenges, the London Stock Exchange Group has identified Scope 3 as one of the most vexing problems in climate finance. Scope 3 emissions, generated by a company's customers and supply chains, often constitute more than 80% of its total carbon footprint, and in sectors like oil and gas, this figure can be even higher (PricewaterhouseCoopers [PwC], 2022). Regulators in the EU, Japan, the UK, and the U.S.A. are currently evaluating whether public corporations should be required to disclose their Scope 3 emissions. For instance, the UK's Financial Times Stock Exchange (FTSE) Russell has emphasized that addressing the "Scope 3

conundrum" is "essential for a clear assessment of climate risks faced by companies". However, incorporating Scope 3 data into risk governance for portfolio analysis and investment decisions is often hindered by the complexity of Scope 3 accounting. This complexity arises from low disclosure rates, inconsistent data quality, and poor comparability, according to a FTSE Russell report. North American companies are also grappling with the challenge of understanding, calculating, and disclosing their Scope 3 emissions (Tiley & Sin, 2023).

The challenge of Scope 3 reporting is exacerbated by the complexities of collecting and analyzing data from suppliers (Klaver et al., 2023). Jaako Kooroshy, the global head of sustainable investment research at FTSE Russell, stated: "On the one hand, it's really critical; we need this data and we need to understand it and bring this into the investment process, not least because there's real business and regulatory risks attached to these Scope 3 emissions, […] but on the other hand, we don't really have the mature data sets to do this" (Marsh, 2024c, para. 6).

FTSE Russell's findings indicate that only 45% of the 4,000 medium to large publicly traded companies in the FTSE all-world index disclose Scope 3 data, and fewer than half of these companies report on the most significant emissions categories for their sector. Unlike Scopes 1 and 2 emissions, which stem from a company's own operations and purchased energy, assessing Scope 3 emissions accurately is far more challenging.

Recent research by FTSE Russell suggests that investors should focus on the two most significant Scope 3 categories (out of the 15 total): Purchased goods and the use of sold products. These two categories account for an average of 81% of an industry sector's total Scope 3 emissions. For instance, in the energy sector, purchased goods and the use of sold products represent 88% of Scope 3 emissions, according to FTSE Russell's research. Kooroshy commented, that by simplifying the problem and narrowing the lens in this way, "you get your arms around the lion's share of the problem" (Marsh, 2024c, p. 15). Unfortunately, this "lion's share strategy" is not being followed by the U.S.A. SEC. In its final climate-related disclosure rules, it removed the mandate for U.S.A.-listed public companies to report Scope 3 emissions, which had been included in the initial draft released in March 2022. However, these final rules do require disclosure of any oversight by the board of directors of climate-related risks and any role by management in assessing and managing the registrant's material climate-related risks (SEC, 2024; Beyoud & Hirji, 2024).

Scope 3 emissions make up more than 70% of a company's carbon footprint, according to consulting firm Deloitte, compared to an 80% estimate from FTSE Russell. The new SEC rule is seen as a victory for many corporations and their trade groups, who successfully lobbied to soften the regulations, which still mandate disclosures for Scopes 1 and 2 emissions. Similarly, the EU's requirement for mandatory Scope 3 disclosures for publicly listed companies has been postponed. This could complicate compliance for global companies listed in multiple jurisdictions. Practical resources, such as Celsia's (2023) guidelines for calculating the EU taxonomy's key performance indicators (KPIs), can assist companies in navigating these complexities and ensuring adherence to European sustainability standards.

The SEC's proposal in March 2022 would have mandated publicly traded companies to disclose a variety of climate-related risks that could impact their operations, emphasizing the importance of GHG emissions disclosures for investor due diligence. Companies resisted, citing the difficulty in producing such data and potential legal challenges. Grabar et al. (2022) highlight the legal challenges that may arise from the SEC's proposed climate disclosure rule, particularly concerning the requirement for Scope 3 emissions reporting. They argue that the rule could face substantial obstacles related to the materiality of these disclosures and potential conflicts with fiduciary duties, making litigation highly likely. Addressing this risk governance issue, Ben Schiffrin, director of securities policy at the investor advocacy group Better Markets, remarked: "There is no question Scope 3 reporting is important; [without it] you risk presenting a somewhat misleading picture of the company's greenhouse gas emissions" (Prentice et al., 2024, para. 19).

6. CONCLUSION

This paper aims to explore and recommend strategies for asset managers, investors, corporate executives, and boards of directors to evaluate risk governance in ESG investing and activities. While the current literature offers numerous studies on ESG activities, it lacks a focus on the risk governance aspect of ESG investments. These stakeholders also play a crucial role in determining whether ESG investments and activities are aligned with and providing value to, shareholders, customers, employees, communities, and other key stakeholders. The main findings of this research indicate that effective risk governance in ESG investing requires a multifaceted approach that includes robust monitoring mechanisms, transparent disclosures, and strategic alignment with long-term sustainability goals. The proposed strategies and frameworks provide practical tools for stakeholders to distinguish genuine ESG commitments from superficial ones. The research highlights the importance of addressing greenwashing and greenhushing to maintain credibility and stakeholder trust.

For asset managers, investors, corporate executives, boards of directors, and other stakeholders, ESG criteria should include risk management, investment, profitability, liquidity, and sustainability. These stakeholders have the fiduciary duty to ask questions about an organization's approach to ESG activities, data management, strategic planning, and efforts to achieve sustainability objectives. There have been companies and individual board members being sued for not living up to the goals that they committed to.

Liv Watson, a digital sustainability advisor at Capitals Coalition, said: "Before we were able to just look at data points, but now we have to look at more complex dependencies. We also can't just look at the data we have internally for coming up with metrics to impact business; we have to look at climate risk" (Butcher, 2023, para 15).

She listed five risk management, ESG questions related to climate risk for asset managers, investors, corporate executives, boards of directors, and other stakeholders to assess (Butcher, 2023):

- Are your own or your suppliers' physical locations going to flood in the future?
- Are you in a place where there's been drought and water running out?
- Are you living in a place where the raw materials can't supply your business's needs anymore?
- To what extent can ecosystems and natural resources sustain the economic development and profitability that you're expecting on your balance sheet?
- Are there political issues or geopolitical conflicts that could disrupt your long-term strategic plans or operations?

A solid foundation for risk governance in ESG investing and activities by asset managers, investors, corporate executives, and boards of directors is to follow key principles outlined in Fink's 2021 letter to public company CEOs. This includes urging companies to disclose their plans for aligning with a net-zero economy and ensuring that these strategies are reviewed by the board of directors. This paper highlights and advocates the four key strategic climate points from Fink's 2021 CEO letter as a useful monitoring checklist (Fink, 2021).

By utilizing these CEO strategic climate points, various stakeholders can evaluate whether their companies are genuinely committed to managing the risks associated with their ESG investments and activities, or if they are engaging in greenhushing by downplaying or concealing their net-zero goals and environmental credentials, or in greenwashing by making empty commitments without delivering tangible results. An increasing number of companies are trying to shield their climate pledges from public scrutiny. According to findings from the South Pole consultancy, the fear of being accused of greenwashing — where a company overstates its environmental efforts — has become so pervasive that executives are willing to go to great lengths to avoid it.

Being branded as a "greenwasher" can lead to reputational harm, financial losses, and increased regulatory scrutiny. Companies accused of greenwashing often find it challenging to restore their reputations. A highly effective investigative method is to apply Bloomberg Green's framework, which assesses the potential for greenwashing, including the complexities of the Scope 3 emissions issue (Poh, 2023). The research implications are significant, as this study provides a foundational framework for further empirical research in risk governance of ESG investing. By addressing the gaps in existing literature and offering actionable insights, this paper contributes to the development of more effective ESG practices. By providing a detailed framework and highlighting key areas of concern such as greenwashing and greenhushing, it encourages deeper investigation into effective risk governance strategies. However, this research is not without its limitations. The reliance on content analysis and the challenges of measuring ESG performance objectively may affect the generalizability of the findings.

In summary, this research paper has recommended various risk governance strategies for monitoring ESG investing and activities by asset managers, investors, corporate executives, boards of directors, and other stakeholders. Specific strategies included five risk management ESG questions, four CEO strategic climate points, and seven greenwashing questions. Future research could explore these risk governance strategies and approaches through case studies or empirical investigations, particularly to assess the relevance and value of ESG investing and activities.

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