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The backdrop to Socially Responsible Investment (SRI)

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Abstract

In recent years, sustainable development has become the essential objective to be achieved in the strategies developed and promoted by the International Community. The great environmental crisis we are experiencing, together with the numerous social catastrophes and the corporate instability or deficiency that unfortunately characterises many corporations at international level, has led the private sector, and specifically many financial institutions, to want to help minimise these disastrous consequences through the incorporation of financial analyses that take into account Environmental, Social and Governance (ESG) variables when developing their strategies.

The rise of Socially Responsible Investment, commonly known as SRI, has positioned the private sector and in particular the financial industry, which until now has been frivolously dismissed as capitalistic and self-serving, as a necessary driver of sustainable change. In other words, through the ESG investment strategies that have been adopted, not only has economic growth been boosted by the continuous search for profit and profitability, but it has also consistently contributed to the achievement of the internationally agreed sustainable development goals.

In view of this revolutionary phenomenon and taking into account those detracting or critical theories that vehemently allege the existence of a dark and reprehensible underworld in these financial instruments; this paper will analyse in detail, using case studies with a particular focus on environmental impact investments, the real impact that Socially Responsible Investments have on our society and the obstacles they face in terms of volatility, profitability and transparency.

Keywords: ESG, investments, greenwashing, profitability, compliance, taxonomy, capitalism, SDGs, social responsibility.

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Index of abbreviations

SRI	Socially Responsible Investment
SDGs	Sustainable Development Goals
ESG	Environmental, Social and Corporate Governance
Op. cit.	Opus citatum, "in the above-mentioned work"
Ibid.	Ibidem
UN	United Nations
ISO	International Organization for Standardization
EUGBS	European Green Bond Standard
SMEs	Small and medium-sized enterprises
ESMA	European Securities and Markets Authority
EUVECA	EUVECA - European Venture Capital Funds
MMFs	Money Market Funds
SFDR	Sustainable Finance Disclosure Regulation
NFRD	Non-Financial Reporting Directive (Directive 2014/95/EU)
ETFs	Exchange-Traded Funds
SIBs	Social Impact Bonds
UCITS	Undertakings for Collective Investment in Transferable Securities
IBRD	International Bank for Reconstruction and Development
CSRD	Corporate Sustainability Reporting Directive
AIFMD	Alternative Investment Fund Managers Directive

INTRODUCTION

Sustainable investment products have become one of the preferred options for most 21st century investors. Such an interest, rooted in the desire to curb the increasing social and environmental needs that threaten our ecosystem, has opened up a hitherto unexplored avenue that diverts funding flows from large corporations and private sector companies to sustainable initiatives characterised by the 2030 Agenda and the globally agreed Sustainable Development Goals.

Despite the widespread criticism of the true intention and background of this type of financing, official sources have confirmed a clear trend in recent years in the incorporation and increase of assets in Socially Responsible Investment (SRI) portfolios; increasing by more than 300% between the end of the 20th century and the beginning of the 21st century[1]. Many studies and data comparisons tend to indicate better performance and scores for investments that integrate ESG criteria into their strategies. This reality, together with the boost given in recent years to social and environmental awareness on the part of executives and the international community as a whole, has led the financial sector to begin to turn green and advocate projects with sustainable values as their flagship.

However, as this is a reality that has so far not been germinated and homogenised in our system, there are numerous legal loopholes concerning not only the classification of these types of instruments, but also the veracity of the assessments in numerical terms carried out by specialised data providers. Therefore, taking into account the liquidity that currently characterises our financial system and the major regulatory changes that are taking place in this area, a detailed study of socially responsible investments will be carried out (although focusing to a greater extent on investments based on the environmental factor), taking into account the regulations in force to date, the advantages that this type of financing entails and the threats or disadvantages that arise from these means.

[1] Aktas, N., de Bodt, E., & Cousin, J. (2011). Do financial markets care about SRI? Evidence from mergers and acquisitions. *Journal of Banking & Finance, 35*(7), 1753-1761.

CHAPTER 1. PURPOSE AND METHODOLOGY

With the establishment of the SDGs, there has been a considerable increase in the awareness of executives, international organisations, and other geopolitical actors in the current international system to achieve economic, environmental and social sustainability. The private sector plays an essential role in our society as one of the fundamental pillars for the successful joint achievement of sustainable development goals. However, far from only expecting companies to carry out philanthropic actions, the aim is to establish a joint awareness that conceives these responsibilities as a genuine and necessary commitment that is materialised in actions characterised by transparency and effectiveness. In other words, "social responsibility must be assumed as a management tool, as a measure of prudence and as a demand for justice"[2].

It is inherent that in order to effectively and successfully achieve all the proposed objectives, a financial engine must be in place to fund and channel the flow of money to achieve the proportionate share of capital for each initiative to be achieved. This reality, together with the great development of financial products, and investment funds in particular, has led to an increase in the number of so-called socially responsible investment funds or socially responsible investment funds, whose portfolios are made up of assets that take ESG criteria into account, allowing them not only to address the traditional risk-return scheme, but which are committed to having a positive and tangible impact on society, be it in environmental, social or corporate governance matters.

However, despite the large number of financial instruments that have been developed claiming to incorporate these values and standards as the basis of their strategies, many have been criticised for their veracity and transparency. Many others have also argued that far from being concerned with improving social welfare and sustainability, a large number of institutions make capital outlays into ESG funds under the mere pretext of camouflaging their capitalist interests of risk minimisation and profit maximisation behind a green façade that puts them at an advantage over their competitors in terms of sustainable engagement. Therefore, in order to determine the background of

[2] Garriga, E., & Melé, D. (2004). Corporate social responsibility theories: Mapping the territory. *Journal of business ethics*, *53*(1), 51-71.

socially responsible investments and the real intentions of those companies adopting such strategies, a detailed analysis of data collected from case studies and true comparisons will be carried out, which tend to analyse the different impacts between traditional investments and those that take ESG criteria into account.

CHAPTER 2. FINANCIAL CAPITALISM

2.1. Theoretical framework

The rapid increase in the volume of international transactions, global capital flows and technological progress in recent years has led to the establishment of global state interdependence. The dissolution of borders and the integration of social and political values are two of the most important factors in the change of political order experienced as a result of globalization. This phenomenon, which germinated at the end of the Cold War, laid the foundations for today's multipolar international system, leaving behind a bipolar system fully differentiated between the Soviet bloc and the capitalist bloc led by the United States.

The need to promote individual liberties and economic progress meant the need to reform the conflicting models in place. Liberalisation of the political, social, and economic spheres was necessary to achieve progress and development. Globalisation thus acted as an expansive slingshot in the spread of capitalism, having a direct impact on the financial system of the powers that be. From then on, free markets began to be conceived as the best option for organising the economic system of states, for obtaining profits, and therefore for structuring the financial engine of a prosperous territory. Although capitalism is strongly criticised by the advocates of socialism who advocate the placing of the means of production solely in the hands of the state and the mere pursuit of what they call social welfare, capitalism is seen as the most rational and prosperous system, converging the benefits and interests of the parties.

Its characteristic features therefore include a) the right to private property, enabling citizens to own tangible and intangible assets; b) the uncoordinated interaction of individuals being driven by self-interest and guided by the invisible hand as Adam Smith argued; (c) the existence of effective competition that allows market players to enter and exit the market freely in a way that promotes the social welfare of both consumers and producers; d) price setting based on the interactions of the market and its agents without state intervention; e) the importance of market actors as opposed to the secondary role played by the executive, which is limited to protecting citizens' rights and maintaining a minimum order that allows markets to function properly. Depending on the intensity and degree to which these factors converge, we can observe different sub-types of capitalism, those in which the role of the state is non-existent, commonly known as laissez-faire economies, and those that could be referred to as mixed economies, where the participation of the executive is essential to regulate and correct market failures and strengthen public security.

However, regardless of the capitalist conception that economies adopt, it is clear that the adoption of such a system has favoured the exchange of monetary and savings-investment flows with third countries, creating a mechanism of feedback and financial interdependence at a global level. It should be noted that the phenomenon of internationalisation, which began after the fall of the Bretton Woods system, went hand in hand with the weakening of the dollar and the succession of different crises and, with it, indebtedness, and speculation at the international level, affecting the financial system of all the powers that had been established up to that time in a very negative way. Therefore, as Coq Huelva pointed out, states were strongly obliged to resort to the capital markets, especially international ones, as a method of financing to compensate for the high debts and deficits they had been accumulating[3].

It was at this point that the secondary market became a real channel for the circulation and trading of highly liquid debt securities. Indeed, it was this need for interconnection, coupled with technological breakthroughs that reduced time and space barriers, that led to the establishment of a financial ecosystem based on the stock market for investments and stock market trading, which in turn constituted the backbone of the international economic system. It can therefore be concluded that it was at the end of the 20th century that globalisation coupled with financial capitalism effectively materialised

[3] Barbosa Ramírez, D., Medina López, C., & Vargas López, M. (2014). Globalización, capitalismo financiero y responsabilidad social empresarial: tensiones estructurales. *Civilizar Ciencias Sociales y Humanas*, *14*(27), 135-154.

and confirmed the feasibility of making profits through interaction in the various international markets characterised by savings planning.

It was within this same financial capitalism that the concept of Corporate Social Responsibility emerged, which is one of the fundamental pillars to be taken into account by companies, although it has undergone major changes as social values and ideals have evolved. The term arose as a result of increased awareness-raising campaigns by national institutions such as the International Labour Organisation and the United Nations, which aimed to effectively safeguard social and workers' rights and advocate transparency. In sum, these were a set of responsibilities of a social and corporate governance nature that had hitherto not been contemplated or were not considered so important for the proper functioning of the company. However, despite being an important milestone in the business and financial world, it could be argued that it was at this point that controversy began to arise over the adoption of certain policies. Firstly, there is a big question mark over the profitability and profitability of the results obtained from the involvement in social agreements, in comparison to traditional investments that were aimed solely at the financial enrichment of society itself, as questioned by economists such as Milton Friedman; and, secondly, the great reputational dilemma associated with those companies that allocate part of their assets to finance social initiatives, which we will refer to later.

Regardless of the controversies that have arisen and the major criticisms that can be derived from such practices, there is great interest at the supranational level that the governments of financial institutions and companies should adopt measures to contain the advance and eradicate the disadvantages caused by the dark side of globalisation, such as global warming, corruption or attacks on human rights and the dignity of people, especially workers. Among the documents and initiatives that have had the greatest impact are a) the Caux Round Table, one of the first initiatives carried out at the beginning of the 20th century, which brought together efforts to establish a unified definition of what was considered to be social responsibility and to determine its foundations; b) the publication of the UN Global Compact, which contained social, environmental and sustainable principles that were implemented in more than 145 countries around the world by trade unions, non-governmental organisations and companies[4]; c) the Green Paper, which encouraged smaller companies located in the territory of the European Union to comply with good financial, social, environmental and professional practices in the field of employment.[5]; d) the Draft Human Rights Standards for Workers developed by the UN Commission on Human Rights, which as its name indicates, the main objective of these precepts is to ensure the welfare of workers and to guarantee the absence of discrimination by means of periodic reviews; and lastly and most importantly, the ISO 26000 standard drafted and published by the International Standards Organisation, as it set out the procedures necessary to implement all the behaviours and standards hitherto envisaged at the stakeholder level, in order to guarantee their protection[6].

Therefore, it can be concluded that since the beginning of the implementation of financial capitalism we have experienced an evolution in the values and characteristics that govern this system. There has therefore been a radical change in its rationale, as, although daunted by successive global economic crises and instability, there has been a shift from an arduously realistic mentality that sought to make profits regardless of the actions taken or the consequences that flow from them; to a position that has even been labelled philanthropic by some detractors, in which values such as transparency, good ethical and professional conduct as well as respect for human rights are raised as a banner, outlining the strategic lines of business conduct.

2.2. Investment funds

Investment funds are currently one of the most popular financial products among the global public. In recent years, the number of companies and families that have opted to change the composition of their portfolio by transferring part of their financial flows to these collective investment institutions has grown exponentially, with this preference

[4] Montuschi, L. (2010). Desarrollos recientes en los instrumentos para integrar la RSE a las operatorias de las empresas. *Serie Documentos de Trabajo*. 439, 1-31.

[5] Campos, F. (2008). Responsabilidad Social Empresarial: Comunicación bajo ISO 26000. *Chasqui*, (102), 48 - 53. Centro Internacional de Estudios Superiores de Comunicación para América Latina. Quito, Ecuador: CIESPAL. Recuperado de: http://revistachasqui.org/index.php/chasqui/issue/viewIssue/102_2008/45

[6] *Ibid*.

being marked by the high profitability and favourable taxation of these instruments. The large number and diversity of savings-investment funds on the market has led to the development and adaptation of numerous regulatory specificities that have been introduced in the financial system in recent years, but most of them share not only the basic concept but also the same characteristics and internal structures. These include retirement plans, pension funds, real estate investment trusts and even private equity funds.

Investment funds are collective investment undertakings whose assets consist of the monetary contributions (investments) made by the unit-holders; each member owning the fund in proportion to the amount contributed respectively and allocating collective results on a pro rata basis. As it has no legal personality, the only way of interacting with the markets and unit-holders is through a management company, which is responsible for determining the fund's investment strategy, ensuring at all times that the performance and security of savings are enhanced, as well as carrying out administrative and representative functions; and, on the other hand, the depository company, whose main function is the guardianship and custody of the assets of the same.

In addition to being a vehicle that offers great advantages to investors, as described below, mutual funds are an essential part of the Spanish financial system. So much so that in 2005, collective investment institutions accounted for forty percent of Spanish GDP and twenty percent of household assets in Spain. In other words, it is the most important investment vehicle for private investors, as it not only gives them quasi-direct access to the capital markets, but also allows them to benefit from the advantages of professional management of these financial instruments, which in the vast majority of cases is based on asset diversification. Also, increases in the efficiency of investment at the national level are very positive as, in parallel with the increase in savings-investment flows, the country's productivity rises[7].

Not all investors make capital contributions in the same types of investment funds or those with similar portfolios; i.e. the contributions of cash flows vary according to the

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[7] Fundación Inverco (2007). *Medio siglo de inversión colectiva en españa***.** Last accessed March 2022 from: https://www.inverco.es/archivosdb/medio-siglo-de-inversion-colectiva-en-espaa.pdf

profile of the potential investor, which is biased by the risk he/she is willing to take, the fund's performance expectations, the type of asset, etc. It is therefore essential to make a brief reference to the types of investment funds that can be found in the Spanish market in order to have a broader view of the industry and then to enter into the sub-type of socially responsible investments with greater clarity.

First, there are fixed-income mutual funds, which are so called because they allocate the vast majority of their assets to fixed-income assets, i.e. bonds, notes, bills or bills of exchange. In this category of funds, the most important elements to take into account are, on the one hand, the interest rate, as this will be the characteristic that will determine the fluctuations in the value of its units; and, on the other hand, the term to maturity of the assets, since the shorter the term to maturity, the lower the risk assumed and, at the same time, the yield will fall considerably. Conversely, the longer the maturity of assets, the greater the risk assumed by the shareholder, but the return will grow exponentially. Unlike the assets in which fixed income funds invest as specified above, equity funds focus on investing their assets primarily in equities, which are constituents of equity assets. The risk of this type of fund is higher than that of fixed-income funds. On the other hand, there are mixed funds, which combine the characteristics of the two aforementioned, as the fund's assets are invested in both fixed-income and equity assets, with the risk therefore varying according to the percentage and type of assets invested in.

While in the funds described so far there is a clearly defined portfolio in which the assets to be invested are established, there are other types of financial instruments in which this organisation is not so evident or which do not have a clearly defined investment policy, as is the case with global funds. This type of fund, which in turn encompasses a number of other sub-types, is characterised by the fact that it has complete freedom in the management of its investments without fixing them in advance, which entails a high level of assumed risk. Guaranteed investment funds are another type of investment instrument in great demand by shareholders today, as they undertake to return to participants the amount of money originally paid in and sometimes undertake to distribute profits and income within a certain period of time. Finally, there are investment fund structures called compartment funds, which are composed of sub-funds with fully differentiated portfolios; In other words, we are dealing with an umbrella structure in which each branch, so to speak, establishes the type of asset in which it invests and therefore its return, net asset value and level of risk. However, it should be made clear that the range of investment funds envisaged here does not reach its maximum in these types; On the other hand, in view of the dynamic landscape characterising the financial system and the social reality as a whole, there are other types of collective investment institutions, such as real estate investment funds, investment trusts, listed funds, hedge funds and foreign collective investment institutions, among others.

One of the characteristics and most attractive features of this type of financing instrument is the tax advantages they enjoy, as mentioned above. However, it should also be noted that the results of the fund's activities, whether they constitute income or losses for the unitholders, will not be effectively received by the investors until they have redeemed the units. Therefore, from a Spanish regulatory perspective, it will not be until that moment that the transfer of assets will be considered as a transfer of assets for tax purposes and, therefore, capital gains will not be taxed until that moment. Another feature that attracts the public to this type of financial instrument is the diversification of investments, as well as access to a greater number and diversity of funds that could be accessed by an individual willing to invest. This is an essential feature to take into account when executing an investment, as it will reduce potential risks and offset losses on certain products against gains on others. It can therefore be argued that collective investments allow participants to access economies of scale while incurring minimal costs when operating in the markets.

Finally, it is equally important to know the criteria by which investors make monetary outlays into one or the other type of investment fund. First and foremost, and forming the basis for shareholders' choices, are the prospectuses and key investment policy documents, which set out the fund performance derived from the net asset value obtained by dividing the fund's total assets by the units outstanding. However, it is inherently risky as it is an investment product whose consequent gains or losses vary depending on external agents, as reflected in the position of the markets; Potential investors tend to look within these parameters for the volatility and duration of maturity of the assets in the portfolio.

As the years evolved, and with them the interests and preferences of potential investors in choosing investment instruments in which to make monetary disbursements, social and environmental causes became more important and became known as the socially responsible investment movement. These revolutionary movements originated in the late 1960s and early 1970s when importance began to be attached to the actions of companies or the consequences of certain actions, especially if they were related to activities generally considered obscene or offensive, such as those related to pornography, alcohol or tobacco. However, in the late 1980s, with a unified concept of what is now known as sustainability emerging from the Brundtland Commission meeting, the need to achieve the goals of the present without compromising the needs of the future became apparent.

Finally, it is also useful to note that investment funds as a whole, without referring solely and exclusively to those that we refer to as socially responsible investment funds when integrating ESG factors into their models and strategies, are still financial instruments or products that are subject to strict and complex regulation by both national and international regional authorities. Moreover, as these are such new financing methods, the regulations on which they are based, which we will refer to in the following sections, are constantly being revised and adapted to the tax, digital and financial changes that the introduction of new types of products to this market entails.

CHAPTER 3. SOCIALLY RESPONSIBLE INVESTMENTS

3.1. State of play

Globalisation coupled with increased social awareness has encouraged financial markets to transition from an economy based purely on economic profit to one based on sustainability and social justice. In other words, corporate social responsibility has established itself as the epicentre of corporate finance activities. This thinking, which began in the late 1980s, is a turning point not only in the socio-political sphere, but is also of great importance in the field of finance and investment.

It is really confusing to determine exactly what are the sources of ESG-compliant investments. However, numerous contemporary sources and studies conducted by various journalists agree that the first collective investment institutions, albeit with different parameters and ethical values, were aimed at eradicating what were commonly known as "offensive or sinful actions" that were likely to be carried out by companies such as tobacco, gambling, pornography or the testing of products on animals. The beginning of these restrictions and the introduction of ethical and sustainable parameters in the funds' portfolios was due to the fact that the groups that started with such financial instruments are characterised by religious groups such as Muslims, Methodists or Quakers. Therefore, although each one has its own objectives or conforms to certain standards, as in the case of the ethical investment funds that began to emerge on the basis of Shariah law (Islamic law) with the ban on arms, it can be said that it was also in the United States, as well as in the United Kingdom, that the awareness of making investments based on ethical codes began to be forged.

However, thanks to the successive social and environmental movements that arose in the 1960s as a result of the increase in wars and chemical weapons such as in Vietnam, there was a need to take action and promote the discourse of social responsibility, which in turn concerns economic responsibility as it contributes directly to the improvement of community well-being as a whole. The international unification of the term sustainability together with the successive increase of challenges such as gender inequalities, environmental threats or global crises, encouraged investors, especially those using long-term financial instruments, to introduce in some way the risks and opportunities that these factors could bring to the financial field. It was such a scenario that prompted supranational organisations to support the idea of sustainable investments and the introduction of corporate responsibility within companies. So much so that today industry, and in particular sustainable financing, is one of the most important concerns to be taken into account in state agendas and international summits. Furthermore, the COVID-19 pandemic and the consequences it has left behind have led to an exponential increase in public interest in such financing schemes that promise to focus their portfolios on carbon reduction, social equity and sustainability[8].

In conclusion, the profile of investors coupled with the social and environmental demands driven in recent years by the international community have shaped the current global financial and investment landscape. By considering sustainability as a core

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[8] Adams, C. A., & Abhayawansa, S. (2022). Connecting the COVID-19 pandemic, environmental, social and governance (ESG) investing and calls for 'harmonisation' of sustainability reporting. *Critical Perspectives on Accounting, 82*, 102309. Last accessed March 2022 from: https://doi.org/10.1016/j.cpa.2021.102309

element of any investment product, we have managed to move from the traditional selfish conception of primordial capitalism focused on mere profitability to a socially responsible vision that aims to have a positive impact on societies by promoting social welfare and values. These values were established on the basis of international agreements such as the European Green Pact or the Paris climate agreement, which introduced sustainable development objectives into the agendas of national executives that had hitherto been relegated to the background, as was the case with the adoption of the seventeen Sustainable Development Goals integrated into the 2030 agenda, which aim to improve well-being, from promoting education and social equality to ensuring the safeguarding of terrestrial ecosystems and the environmental outlook.

3.2. Objectives and mechanisms for their channelling

Sustainable, socially responsible, or sustainable investments that comply with Articles 8 and 9 of the EU Sustainable Finance Disclosure Regulation (SFDR) [9] are primarily aimed at moving away from a purely economic and selfish approach to the defining lines of the Sustainable Development Goals and focusing on environmental, social and corporate governance factors.

A priori, all these objectives could even be considered idyllic, given the greedy and selfish nature of many people, but they would remain mere wishes if they had not been channelled into binding international normative sources that imply the involvement of states. As such, these initiatives have been reflected in numerous international texts ratified by different States, as was the case in 2015 when the seventeen Sustainable Development Goals (SDGs) promoted by the UN were adopted, as well as tracked and evaluated by numerous social indices such as the MSCI KLD 400 Social Index.

Institutional investors' returns and profits depend on the functioning and health of global financial markets as their long-term investment portfolios have a high degree of diversification, promoting a sustainable market in order to reduce risks. The appetite for such sustainable markets and investments is in direct proportion to the reduction of risks

[9] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (Text with EEA relevance). *Official Journal of the European Union.* Last accessed March 2022 from: https://eur-lex.europa.eu/legal-content/ES/TXT/?uri=celex:32019R2088

and the increase in micro and macroeconomic opportunities. Furthermore, one can even speak of a homogeneous system of promoting investment strategies between companies through which to evaluate the actions, commitment and results obtained by converging on the same language.

Consequently, questions arise about how to address ESG factors and how they can be channelled to effectively obtain investments that have a real impact on our reality. Different versions of integrating the sustainable paradigm into corporate investment strategies have been identified, although all of them have in common a correct compliance with the fiduciary responsibilities established at the supranational level and embodied in what we know as the Sustainable Finance Principles. It is therefore necessary to distinguish the three ways in which environmental, social and cooperative governance factors can be visualised and integrated into collective investment undertakings at the global level to achieve financial value.

Firstly, there are the consequences of integrating ESG factors into investment strategy and policy. Studies argue that in the long term, investments that focus on sustainable assets will displace non-sustainable businesses from the market as they lead to a real reduction in the cost of capital, resulting in economic results equal to or better than those of businesses that do not take these standards into account and therefore face a much higher risk. On the other hand, the use of ESG factors should be highlighted not only at the internal and structural level of the business, but also in the relationship with the rest of the entities with which it relates, i.e. its external dimension[10].

The objective of this pathway is to raise awareness and encourage the adoption of sustainable products to improve the profile of companies. While it is true that the primary objective is to give recognition to the great benefits of taking into account these factors in terms of risk, profitability and in general the overall business processes and assets, it is easy to criticise the adoption of such measures under the sole pretext of giving a certain image or conception that does not correspond to the reality or the background of their intentions. The controversial "greenwashing" is a clear example of criticism of this option

[10] Programa de las Naciones Unidas para el Desarrollo (2017). *El enfoque de inversión en los ODS*. Principles for Responsible Investment. Last accessed March 2022 from: https://www.unpri.org/download?ac=6243

to introduce the socially responsible component of investments, which we will discuss later. Finally, it is noted that one of the ways of channelling ESG investments is by choosing to allocate capital to sustainable assets with a focus on the social and environmental spheres. Examples of such products would be renewable energies or clean technologies. This is intended to shift the focus away from a backward-looking approach to purely economic profit-making to a more eclectic one where the aim is to make the most not only of the range of factors that characterise capital markets but also of all the opportunities offered by society at large and to account for them in turn through the results they bring about.

On the basis of these theoretical issues, it could therefore be confirmed that environmental, social and corporate governance principles have laid the foundations for the financial system of the future, with the incorporation of the SDGs alongside the social and environmental challenges that pose a real systemic risk not only for the current economy as a whole, but also for investors' portfolios. The reason why these are under constant threat is that there are still many companies in the market today that engage in activities that entail high costs because they are involved in polluting or socially damaging activities, which will eventually lead to a deterioration in the profitability of the portfolio as a whole and in the profits derived from the functioning of the markets themselves. Therefore, in order to maximise returns for the investors themselves, it would be best to opt for investment vehicles that in turn guarantee a capital outlay in products that seek both returns for the investors and for the community in which it is framed, as only in this way will we foster a sound and prosperous financial system.

However, it cannot be overlooked that a large part of the impetus for the private sector as a whole derives from the actions, decisions and regulations developed by national regulatory authorities and institutions. Therefore, failure by companies to comply with these standards would mean that they would opt for investment vehicles with a detrimental strategy that would be contrary to their own interests, would have to bear higher tax burdens compared to those borne by socially responsible investments, and would put them at a disadvantage in the market. Given these circumstances, the following question arises: can we really label collective investment entities as opportunistic and promoting selfish capitalism or should we suggest the same testing ground with the same facilities and once the interests and ambitions of each strategy have been ascertained?

While it is not easy to answer this question, I believe that it is not necessary to label as hypocritical and opportunistic those investment vehicles that want to expand their profitability by investing in sustainable products, because their pretext is to take advantage of the opportunities that the paradigm offers to the new financial methods that are being introduced. Likewise, although it is true that as a result of a capitalist system that is driven by profit and the improvement of the profitability of the products themselves, perhaps the idea of having a tangible impact on society is relegated to the background and taken advantage of to place itself in a better market and competitive position with respect to its competitors; However, it is then that methods, standards and indices that are more effective and unified should be established in order to know the real pretext of such collective investment institutions qualified as socially responsible. Unfortunately, this is almost impossible, because not only do we have a situation in which we will have to deal with each individual case on a case-by-case basis, but we would also be denying the vote of confidence in such products by acting in favour of society and the environment; and on the other hand, for reasons of procedural economy and length of time, as these issues are dealt with by high-ranking bodies at national level.

3.3. Regulatory framework

In order to position Europe as the first ecofriendly continent, the European Union has opted for the development of regulations and strategies focused on achieving these objectives for the year 2030, embodied in the European Green Pact. However, it is a real global challenge as it is essential to reduce total greenhouse gas emissions by more than 55% compared to 1990 levels. We could even call this phenomenon the third industrial revolution in view of the wide range of objectives that are intended to be realised - a considerable positive development in terms of transport, care for our ecosystem, job creation and greater equality in terms of opportunities by promoting social welfare.

It is worth mentioning that in order to comply with the precepts established in the Pact, various initiatives have been developed which, from the point of view of the financial markets, blur the great importance of including these issues in the state and, more specifically, financial agendas, as there is a great desire to replace the traditional markets with others that are committed to sustainability and investment in assets that have positive feedback in society. This ethos, based on the values that form the core of the European Union as a supranational body, is embodied in the strategy on sustainable finance by advocating the fight against climate change and the entry of SMEs in the transition of the financial economy. On the other hand, the implementation of the European Green Bond Standard (EUGBS) established by a group of experts specialised in sustainable finance following the launch of the Commission's 2018 Action Plan on Financing Sustainable Growth and the European Green Pact is noteworthy.

Such voluntary standards would help to boost interest in the green bond market, as once approved they will serve as a pretext for raising capital from capital markets to act as a funding channel for projects that ensure investor protection and sustainability; i.e. those that are characterised by transparency, fall under the EU taxonomy regime, are subject to external review and are regulated and supervised by the European Securities and Markets Authority (ESMA). As a novelty, in order to ensure effective market integrity and to join efforts in the homogenisation of types of investment funds focused on socially responsible strategies, the complementation of Article 8 through a delegated act of the Taxonomy Regulation should be highlighted. This Regulation allows us to identify whether a given economic activity meets the requirements and criteria necessary to be considered sustainable; and, therefore, what would be the degree of environmental sustainability of certain investments.

It is also necessary to consider all the legislative acts carried out by the European Union following consultation of specialised groups. Among all those carried out on taxonomy and related to socially responsible financial activities, the one developed in early February 2022 concerning the acceleration of decarbonisation should be highlighted[11]. In any case, all these strategies demonstrate the clear urgency on the part of executives and international organisations to move the private sector as a whole and its actors towards a sustainable orbit with real and tangible social concerns. Likewise, the taxonomy that is therefore configured as the common language that investors, entrepreneurs and all the agents that make up the financial markets must use in order to be able to identify those projects in which they wish to invest their capital.

[11] European Commission, (2022). *EU Taxonomy: Commission presents Complementary Climate Delegated Act to accelerate decarbonisation.* Last accessed March 2022 from: https://ec.europa.eu/commission/presscorner/detail/es/ip_22_711

In order to promote the economic growth of the powers that be and to ensure the effective functioning and safeguarding of a cohesive market without barriers between Member States, the European Union has joined forces to establish a cohesive regulatory framework applicable to all existing collective investment undertakings. In addition, in order to achieve such a thoroughness in determining the rules applicable to each case, directives applicable to each category of investment fund have been developed. The UCITS directive provides the most comprehensive regulatory framework for investments taking place in Europe, comprising around seventy-five percent of investments made by small investors. On the other hand, there is the Alternative Investment Fund Managers Directive (AIFMD), which covers all those alternative funds that are not governed by the UCITS Directive, i.e., hedge funds, private equity funds, real estate funds as well as other sub-types of institutional funds are included.

Within the group of alternative investment funds there are further sub-categories. In view of the great diversity of financial instruments that can be concentrated in this type of collective investment institution, specific regulations were drawn up for each subtype, regulating their corresponding specificities. In this way, there is the regulation of European venture capital funds (EUVECA), which are essential financing instruments for companies in their early stages of life, since they are mainly aimed at regulating the subcategory of alternative investment funds, which mainly concerns newly created and innovative companies. On the other hand, in view of the increasingly developed social awareness at a cultural and more specifically financial level, it has also been decided to draw up specific regulations applicable to funds intended to finance companies whose activities have a direct social impact. Also taking into consideration investment funds that have among their portfolio investments to intervene in other alternative asset classes, as well as in SMEs and real assets. Finally, there are money market funds (MMFs) characterised by short-term returns and higher security than other types of investment instruments. Due to the great importance given to the latter as one of the most important financial methods for executives, companies and even international institutions, it was appropriate to adopt a unifying regulation that not only guarantees the internal market objectives that characterise the European Union as a supranational institution, but also provides the Member States with a set of precepts aimed at contributing to the constitution of future money market funds capable of resisting negative mutations in the markets.

Having developed the general rules applicable to each type of investment fund, it is appropriate to look at the rules that ensure the proper functioning and safeguarding of sustainable financing. However, what is the underlying rationale for developing a specific valuation system for this field rather than incorporating it into the existing one? The response, while not straightforward, has been largely driven by the COVID-19 pandemic situation and the rise of social awareness in the economic sector. This, together with the increase in humanitarian needs, has brought to the fore an urgent need to direct much of the money in our economies and organisations towards sustainable projects that advocate for climate, social and health improvements. Although this valuation system has been strongly criticised as the real reasons for the adoption of these investments have been questioned, I personally consider that the action developed by the European Union at Community level in the regulatory field of sustainable financing is essential and necessary for the achievement not only of good financial practices and obtaining benefits, but also involves the unification of the concept and meanings of sustainability in the financial field and the development of common standards that allow in a clear and precise way the achievement of the objectives previously defined by the European Green Pact based on environmental sustainability.

It must therefore be stated that the financial sector is indeed regulated at both national and EU level. However, within this sector, one of the branches is beginning to flourish which, although it germinated earlier, has only in recent years acquired the attention, development, and establishment necessary to adopt regulations and acts to determine the roadmap for such investments. Bearing this in mind, it is inherent to conceive that, despite the publication and ratification of legislation regulating this matter in recent months, there are currently numerous directives and projects that are still under the scrutiny of groups of experts, and which are in the queue for processing and subsequent ratification and entry into force. Despite the gaps or uncertainties that we find in the sustainable finance landscape, we must affirm the regulatory pillars of the socially responsible investment sector: a) the Sustainable Finance Disclosure Regulation (SFDR), whose main objective is to make available to end-investors all information on the sustainable risks underpinning all financial processes and products that integrate ESG factors into their strategies; (b) the Non-Financial Reporting Directive (NFRD)[12] known as Directive 2014/95/EU, also aimed at ensuring that large corporations provide society as a whole and investors with a set of data and statistics to show a picture of social, environmental and corruption issues that will enable them to identify the degree of responsibility they assume and the risks to which their internal structures are exposed; and, finally, the Corporate Sustainability Reporting Directive (CSRD)[13] which, in addition to modifying the precepts of the previously established NFRD, establishes the bases for the correct preparation of the sustainability reports that companies have to draw up, including, as a novelty, within the same group all those listed on the stock exchange.

Finally, in conjunction with the previously established regulations, it is essential to be able to establish a classification that allows investors and society as a whole to establish those economic activities that can be considered sustainable and those that, on the contrary, cannot be considered as such. This urgency and need for homogenisation has been materialised in what is known as the European Union Taxonomy, which was promoted by the action plan on financing sustainable growth and has its own regulation under which the Commission develops so-called delegated acts that make it possible to discern those activities that, by meeting certain criteria, could be called environmentally sustainable[14]. Furthermore, the Commission, while playing a key role in the development of such a taxonomy, is assisted by advisors such as the Sustainable Finance Platform, or even by groups of experts gathered in Technical Groups on sustainable finance. In essence, we are faced with a constant regulatory and updating activity, as the social reality and the market players involved in the sustainable finance sector are constantly changing. The introduction of new investment products, the development of innovative strategies and the incorporation of new socially responsible impact objectives are just some of the factors to be taken into account when designing the new EU regulatory landscape brought about by these initiatives.

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[12] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups Text with EEA relevance. *Official Journal of the European Union.* Last accessed March 2022 from: https://eur-lex.europa.eu/legal-content/DE/TXT/PDF/?uri=CELEX:32014L0095&from=EN

[13] European Commission, (2022). *Corporate sustainability reporting.* Last accessed March 2022 from: https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en

[14] European Commission, (2022). *EU taxonomy for sustainable activities.* Last accessed March 2022 from: https://ec-europa-eu.translate.goog/info/business-economy-euro/banking-and-finance/sustainable-finance/eu-taxonomy-sustainable-activities_en?_x_tr_sl=en&_x_tr_tl=es&_x_tr_hl=es&_x_tr_pto=wapp

3.4. Differences with traditional investment

It is clear that the entry of socially responsible investments and products into the capital market with a focus on the 17 Sustainable Development Goals has led to a major shift in the types of assets and investment products in which investors are spending part of their assets. Thus, in order to observe how the incursion of ESG factors has affected traditional investments, the most well-known and characteristic traditional assets on the international financial scene will be presented firstly, and secondly, what we could call their "sustainable version or equivalence".

Firstly, there are bonds; these are conceived as synonyms for debt certificates framed on stock exchanges that promise the payment of a certain amount of money within a certain period of time. These are usually issued either by states or by private companies or supranational organisations[15]. On the other hand, shares can be defined as those transferable securities that constitute the aliquots into which the share capital of a given company is divided. Being a bearer of shares implies being shareholders who own the company in an amount proportional to the amount contributed and may be physically represented by shares or by book entries[16]. Straddling the line between mutual funds and equities are hybrid investment vehicles called ETFs or exchange-traded funds. The main characteristics of this product are accessibility, flexibility, transparency, liquidity and robustness as index funds with the advantage that all units are traded and settled in the same way as shares. In other words, exchange-traded funds can be bought and sold on the stock exchange, putting them in a much more advantageous and favourable position than traditional investment funds, which can only redeem or subscribe at their net asset value[17].

Structured credits are also of great importance when talking about investment products as they are set up as groupings of debts with similar characteristics and subsequently sell the cash flows; i.e. they arise as a result of a securitisation process and therefore take the form of a pool of financial assets that are condensed into packages of

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[15] Roca, M. J. (2020). La sentencia del Tribunal Constitucional Federal Alemán sobre el Programa de Compra de Bonos por el Banco Central Europeo: el control ultra vires y la primacía del Derecho Europeo. *DPCE online*, *2*, 2845-2856.

[16] Comisión Nacional de Mercado de Valores, (s.f.). *Financial Glossary.* Last accessed March 2022 from: https://www.cnmv.es/Portal/Inversor/Glosario.aspx?id=0&term=accion&idlang=1

[17] Gastineau, G. L. (2004). The benchmark index ETF performance problem. *The Journal of Portfolio Management*, *30*(2), 96-103.

securities with their corresponding interests which are subsequently issued to investors. There are no limited issuers of structured credits, ranging from lenders to corporate borrowers[18]. Finally, private investment markets should be addressed, referring more specifically to private capital that is not listed or traded on stock markets, including private debt investments. The attraction of these instruments is that in return for the capital investors pay into these markets, they are provided with access to sources of return that are not available in public markets[19].

Having blurred the picture of the most relevant investment instruments in the international financial market, the impact of the sustainable finance movement and of governance, environmental and social factors has to be assessed. Therefore, firstly, within the Bonds that materialise sustainable objectives, three classifications must be distinguished: a) development bonds, which are issued by banks and financial institutions to finance sustainable development. A vivid example of this is the bonds of the IBRD (International Bank for Reconstruction and Development), which embodies the "World Bank" itself in the capital markets and which, by offering security as well as profitability, all sectoral loans and projects developed have a real positive impact on sustainable development in line with the SDGs[20]. Different from these assets but within the bond category are green bonds, which are fixed income instruments that exclusively finance or refinance long-term environmental projects, also known as "green".

In other words, the capital is mainly earmarked for environmental sector areas such as renewable installations, energy efficiency, clean transport and responsible waste management[21]. The existence of other financing mechanisms such as Social Impact Bonds (SIBs) are essential for the economic, social and environmental development of

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[18] Oaktree Capital Management, L.P., (2019). *Strategy Primer: Investing in Structured Sredit*. Last accessed March 2022 from: https://www.oaktreecapital.com/docs/oaktreecaplibraries/insights-library/market-commentary/investing-in-structured-credit.pdf?sfvrsn=6db67266_1

[19] Rauber, Michael., (2020). Cash and private markets - taking care of the ends of your portfolio. *Julius Bär*. Last accessed March 2022 from: https://www.juliusbaer.com/es/insights/como-invertir/efectivo-y-mercados-privados-cuidar-los-extremos-de-su-cartera-1/

[20] World Bank, (2021). *What are bonds for sustainable development?* Last accessed March 2022 from: https://www.bancomundial.org/es/news/feature/2021/09/28/what-you-need-to-know-about-sustainable-development-bonds

[21] European Economic and Social Committee, (2021). *EU Green Bond Standard - Proposal for a Regulation of the European Parliament and of the Council on European Green Bonds (COM(2021) 391 final - 2021/0191 (COD)) ECO/560.* Last accessed March 2022 from: https://www.ccoo.es/f1c360be2bd85ac5e89e91d1ce5004e9000001.pdf

certain territories, as they are financial instruments aimed at investing capital in social projects and policies addressing issues such as poverty, crime, unemployment, health or education, among others[22]. Lastly, and a great novelty in the capital markets, are the positively evaluated bonds and sustainable municipal bonds, whose main peculiarity lies in the specific financing of both their social and environmental projects[23].

In terms of actions and how they integrate sustainable objectives into their roadmaps, we must highlight the so-called Thematic Investments. This investment option is characterised by long-term capital outlays and by responding structurally to the needs created by technological and geopolitical currents focused on sustainable development[24]. As the name implies, thematic investments are further subdivided into thematic investments by their focus, i.e. they are investments that have a specific purpose and address a particular segment and problem within the sustainable spectrum. Examples include investments in the promotion of renewable energy, health products and inclusive finance, among many other areas that comprise the SDGs[25]. This category also includes those active variable annuities that meet ESG criteria, which last year doubled the flows destined to these funds and are even expected to experience unstoppable growth over the coming years, as shown by the figures published by Bank of America[26].

On the other hand, global investor interest in equity exchange-traded funds focused on sustainable objectives has soared as they not only gain greater market exposure through this type of assets, but also experience improved returns and greater social impact as fees are minimal. However, despite being one of today's most favoured trends, equity ETFs with ESG criteria are now integrated to the point where they account for more than 250 billion euros. These amounts seem to me to be exorbitant considering

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[22] European Commission, (2020). *EIB and Municipality of Madrid promote the city's first social impact bond, putting Madrid at the forefront of social policy*. Last accessed March 2022 from: https://ec.europa.eu/commission/presscorner/detail/es/ip_20_1430

[23] Organisation for Economic Co-operation and Development, (2015). *Green bonds: Mobilising the debt capital markets for a low-carbon transition*. Last accessed March 2022 from: https://www.oecd.org/environment/cc/Green%20bonds%20PP%20%5Bf3%5D%20%5Blr%5D.pdf

[24] MSCI, (2022). *What is Thematic Investing?* Last accessed March 2022 from: https://www.msci.com/our-solutions/indexes/thematic-investing

[25] Principles for Responsible Investment, (2022). *Thematic and impact investing.* Last accessed March 2022 from: https://www.unpri.org/investment-tools/thematic-and-impact-investing

[26] Bank of America, (2020). An*nual Report 2020: Coming together in new ways.* Last accessed March 2022 from:
https://about.bankofamerica.com/annualmeeting/static/media/BAC_2020_AnnualReport.9130a6d8.pdf

the low degree of maturity and establishment of such instruments in the market; nevertheless, well known firms in the financial sector have opted for the development of such types of investment funds such as Nordea Global Climate and Environment Fund or Pictet Global Environmental Opportunities. However, it should be noted that at national level the development of this type of fund is lagging considerably behind the rest of Europe, as has been previously observed[27]. The same is true for structured products and thematic private debt funds whose investment strategies focus on sustainable themes and on creating positive returns with a focus on ESG criteria.

In conclusion, as investors' social, environmental, and corporate governance ambitions have increased in recent years, it was felt that traditional financial instruments needed to be adapted towards a socially responsible approach. The result of all these efforts has had a very positive impact on many sectors of our society, as all the opportunities have been seized to maximise the benefits for the financial sector itself, as well as to expand the hitherto limited niche market for sustainability. Likewise, the social, environmental and even cultural repercussions of all these socially responsible investments have been positively reflected in the fact that more resources have been allocated to projects focused on mitigating the negative impacts, risks and tangible consequences that all these problems entail.

3.5. The importance of ESG investing

Following the establishment of the UN-supported Principles for Responsible Investment, there has been an exponential increase in awareness of ESG factors and their integration into investment asset management strategies. As a result, it was noted that since 2006, the date of its publication, socially responsible investments have gradually increased from 6 million to 60 million in the course of just nine years. In view of this phenomenon, there was a general urgency to promote more information, data and research on this reality, which, although not entirely new, was here to stay for good and to broaden the spectrum it had hitherto encompassed. Consequently, as specialised data providers such as MSCI, Sustainalystics, Morningstar or Bloomberg conducted research and rating studies on ESG

[27] Pagano, M. S., Sinclair, G., & Yang, T. (2018). Understanding ESG ratings and ESG indexes. *Research handbook of finance and sustainability*. Edward Elgar Publishing, 339–371.

investments, an increase in user queries was observed, placing ESG at the centre of attention in the financial world and emerging markets[28].

It shows that as society and commonly accepted values evolve, so do the needs and interests of individuals, companies and institutions. The increased commitment and involvement in sustainability issues among entrepreneurs has been reflected in the vast majority of cases in the strategies adopted, which are shaped in the long term. These strategies, far from being considered positive, are considered strictly necessary, as they not only contribute empirically to risk reduction, as will be discussed later in this paper, but also manage to have a real impact on society without neglecting or compromising the benefits they obtain. Making a real impact in the social, environmental and governance spheres requires real commitment, which is the antonym of short-termism. Therefore, in view of the fact that the horizon of ESG impacts in the financial sphere tends to have long-term consequences, long-term investment strategies began to be designed, with the highest peak in 2013, as the well-known consulting firm McKinsey teamed up with the Canada Pension Plan Investment Board to develop an initiative promoting the financial market and its players to strategies that advocate the favourable nature of long-term investments, called "Focusing Capital on the Long Term".[29]

Financial systems and capital markets are a fundamental pillar for the proper functioning of economies. Factors such as transparency and the proper management of risks through the adoption of measures to mitigate their negative impacts are essential to achieve genuine economic growth and social productivity as a whole. The ESG investment and finance industry has now emerged as the epicentre of economic prosperity, bringing new products and innovative strategies to the previously established market, bringing diversity and breadth to the markets. Furthermore, by advocating that much of the funding be spent on socially responsible causes such as building hospitals, infrastructure and even housing, it can therefore be argued that ESG investments are

[28] CFA Institute, (2015). Environmental, Social, and Governance issues in investing: A Guide for Investment Professionals. Last accessed March 2022 from: https://www.cfainstitute.org/-/media/documents/article/position-paper/esg-issues-in-investing-a-guide-for-investment-professionals.pdf
[29] Focusing Capital on the Long Term (FCLTGlobal), (2015). *Investing for the Future: A Long-Term Portfolio Guide – Strategy Report.* Last accessed March 2022 from: https://www.fcltglobal.org/resource/investing-for-the-future-a-long-term-portfolio-guide/

necessary to promote the common good and to achieve the Sustainable Development Goals.

Traditional investments ignored these factors by focusing their financing strategies mainly on the short term and therefore the range of spheres involved was really narrow and focused exclusively on obtaining economic benefits without considering or assessing the objectively real risks and externalities that cannot be controlled from a numerical factor. Therefore, when ESG considerations are integrated into this structural system, there is a positive reinforcement phenomenon in the financial system as a whole, while awareness of social and environmental concerns increases, leading to significant actions such as using resources in a more efficient and low-carbon way. Moreover, in view of the major consequences of the COVID-19 pandemic, the importance of this type of investment not only for the recovery of the economy as a whole, but also for society as a whole, taking into account all the sectors involved, can be confirmed.

The most important aspect, in my view, implicit in ESG investments is that the risks they focus on derive from social and environmental realities. The existence of such risks today has major consequences in terms of instability in financial markets and emerging economies, as well as in many cases worsening the social rights that have so far been protected by our democracies and states governed by the rule of law. It follows that the greater the awareness and consideration of the risks that are latent around us, the more specialised the investment strategy of each portfolio will be in focusing on these obstacles and, therefore, the less havoc and negative impact in terms of profitability and returns they will experience. At the same time, by increasing concern about the consequences of these risks, international capital markets would experience less volatility at the macroeconomic level as the obstacles arising from social, cultural and environmental risks would be considerably reduced.

On the other hand, one of the great advantages of ESG factors is that they can be present in all types of assets, although they are more frequent in fixed income, listed equities, and even private equity. However, it should also be made clear that the ratings attributed to individual assets and investments in terms of ESG factors are not static results; i.e. they are cyclical in nature as they vary depending not only on internal factors such as the manner in which and the amount of capital disbursed on the assets; or external factors such as market competition from other competitors or the regulatory and social changes that characterize our dynamic society[30]. Therefore, in order to provide investors with an up-to-date and accurate picture of the results obtained from ESG assessments and ratings, such studies should be carried out with considerable frequency, as over time the profitability, value and behaviour of companies and the capital market have a strong influence on the impact of their assets and thus on the materialisation of the socially responsible factors promoted.

CHAPTER 4. ESG INVESTMENT ISSUES

There are numerous detractors of socially responsible investment products who imminently claim that these products are not viable, that they provide little return in the form of economic benefits, or even that these factors are banal excuses for obtaining tax benefits and better positioning in the market.

4.1. Cost-effectiveness comparisons

First, we need to focus on the main purpose of capital outlay in the form of investments in certain products whose main objective is to make a profit. When addressing this issue in ESG investments, one must first look at the indices and ratings provided by different entities that allow a classification to be established as to which types of investments comply with sustainable factors and objectives. Once these parameters have been analysed, we can go on to establish whether or not there is a real correlation or proportional relationship between the money invested in social and environmental initiatives and the profitability derived from their results; or, on the contrary, if these investments result in mere losses of financial flows.

Such a way of carrying out comparisons and establishing accurate and helpful developments for investors would be helpful if all financial vehicles were analysed with the same ESG standards and criteria. However, in the absence of international unification or homogenisation of the judgements used to classify and score different investments, it could be argued that full transparency of investment vehicles within the financial

[30] Conen, R., & Hartmann, S., (2019). The hidden risks of ESG conformity-benefiting from the ESG life cycle. SSRN papers, 2-35.

paradigm has so far not been achieved. However, although there is no agreement on the guidelines used to determine these rankings, it is clear that each of the entities that carry out these rankings rely on the standards determined at EU level to guide investors in choosing which type of product best suits their claims and interests. It is therefore inherent in these statements that the results obtained from a given rating index would not coincide with, let alone reflect identical results to those obtained from other rating indices as the method carried out may assess different ESG risks and factors with a different score than the previous rating mechanism.

The absence of linear standards of comparison between indices and entities therefore makes it theoretically impossible to carry out research that takes as a reference heterogeneous qualifying parameters outside the same indicator. However, from the opposite perspective, what would provide a completely faithful and transparent picture of the comparisons carried out would be to make these evaluations using the same index. Therefore, in the case of comparing the performance and profitability of more than one investment over a period of time, highly reliable results would be obtained by taking into account homogeneous requirements in the evaluations. Thus, we could establish through these parameters whether there is indeed a correlation between paid-in capital and improved returns from socially sustainable investments as opposed to traditional (non-ESG) investments.

Before drawing conclusions about whether investments focused on sustainable objectives have better outcomes, we must look at the examples illustrated in the graphs provided by Morgan Stanley's Institute for sustainable investing, which compare the risks and returns of these investments using Morningstar data published from 2004 to 2018. First, the returns of both types of investments are analysed as shown in graph 1 and chart 1. The figures derived from the studies carried out taking into account homogeneous parameters within the same index taking into account the profitability of investments, clearly show that there is a clear similarity between the results obtained from one and the other, with insignificant discrepancies or alterations over time that do not constitute values to be taken into account in the strict sense of the term. Therefore, it was concluded that the performance experienced in both cases is very similar numerically over economically stable periods.

However, an appreciation must be made in favour of socially responsible investments, as these are the ones that experience a marked improvement in periods of higher volatility, as was the case at the end of 2018 (graph 2). This compares returns over three months (from October 2018 to December 2018) of complete financial decline and volatility where stock market indices such as the Dow Jones Industrial Average experienced same-day changes of more than 1%. In short and referring to the data above, with a clear difference of 1.39% (significant at the 99th percentile) ESG investment funds outperformed the revenues and hence returns derived from traditional funds[31].

Although the results in the period of the survey seem surprising, they are consistent with the conception that many value socially responsible investment in terms of risk, as shown in graph 3. Far from the widespread conception of philanthropism embedded in ESG-qualified investments, their sole efforts are to promote goodwill at the socio-cultural level; Researchers such as John Hale, head of sustainability research for the Americas region for Morningstar, and MacMahon, head of corporate governance and ESG research at Sustainalytics, argue that they should be conceived as metrics that objectively enable businesses to manage risks as well as evaluate material opportunities and assess the tangible impact they have on the world[32]. This is therefore an essential factor for investors themselves to be able to understand those facets of investments that are more difficult to assess and evaluate in their internal strategies. By encouraging what in my view would constitute an increase in transparency in decision-making and in the underlying interests of the capital paid up in certain products, the case is being made for fostering the mainstreaming of such initiatives. Without digressing from the present topic, it can therefore be said that ESG factors serve to channel in an optimal way the risks currently affecting the financial market and economies as a whole.

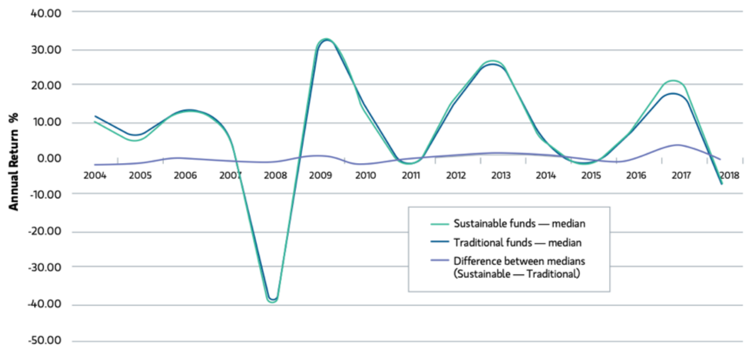
Hence, it can be stated that, although on the one hand, the actual return on sustainable investments is not much higher than that obtained by traditional investment funds, it is objectively profitable in financial terms to invest in these types of products

[31] Morgan Stanley, (2019). *Sustainable Reality: Analyzing Risk and Returns of Sustainable Funds*. Last accessed March 2022 from: https://www.morganstanley.com/content/dam/msdotcom/ideas/sustainable-investing-offers-financial-performance-lowered-risk/Sustainable_Reality_Analyzing_Risk_and_Returns_of_Sustainable_Funds.pdf

[32] Norton, L., (2021). Sustainable investment works. *Morningstar, Inc*. Last accessed March 2022 from: https://www.morningstar.es/es/news/215460/la-inversión-sostenible-funciona.aspx

and assets because of the income derived from their performance in the market. In other words, those who claimed that ESG investments posed an imminent danger to the financial markets and to portfolios that were betting on the incorporation of investment products were wrong; and therefore instead of branding sustainable investments as broken bags with no apparent benefits, they should be conceived as equally (or better) viable novel alternatives to the financial products we are used to dealing with so far.

Graph 1: E, S, and G categories and their relation to CFP



	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Difference in median returns (Sustainable - Traditional)	-1.50 **	-1.17	0.18	-0.37	-0.80	0.84	-1.37 **	-0.08	0.63	1.38	1.18	0.00	-0.23	3.63 ***	-0.03
Statistical Significance	99%+ ***			95%+ **			90%+ *								

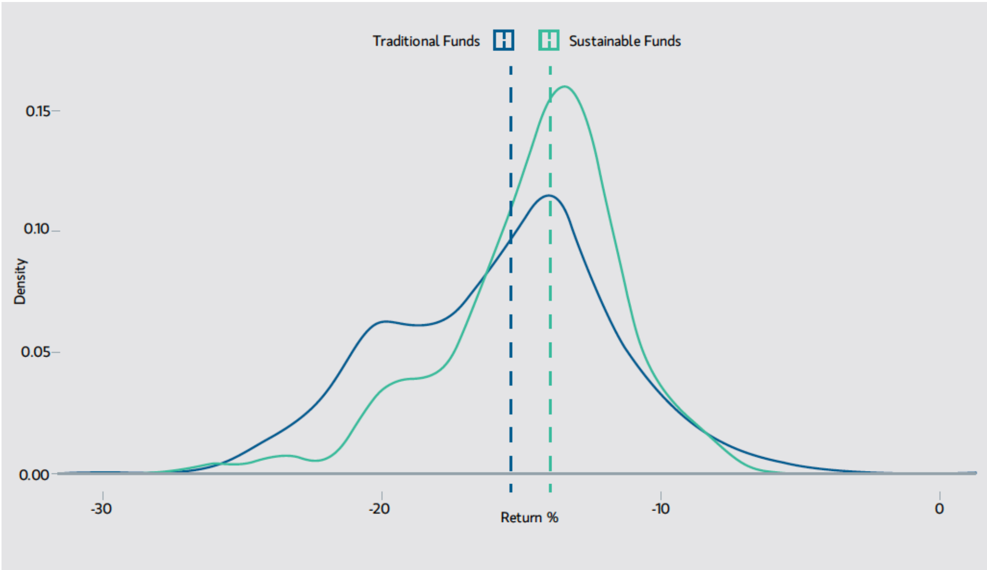
Source: Morgan Stanley, (2019). *Sustainable Reality: Analyzing Risk and Returns of Sustainable Funds*.

Chart 1: Annual Median Total Returns (%) of Sustainable and Traditional Funds by Asset Class, 2004 – 2018.

Asset Class		2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
International Equity	Sustainable	16.09	14.29	23.16	14.97	-44.78	35.38	12.40	-13.92	17.42	20.52	-1.80	-1.47	4.58	26.19	-13.59
	Traditional	18.25	15.20	25.42	12.72	-44.97	36.99	13.86	-14.01	17.89	19.36	-3.08	-2.86	3.79	26.85	-14.42
	Sustainable - Traditional	-2.17	-0.91	-2.26	2.25	0.20	-1.60	-1.46	0.08	-0.48	1.16	1.28	1.38	0.78	-0.67	0.84
Sector Equity	Sustainable	37.19	17.67	47.49	-12.26	-44.93	41.07	17.62	-8.71	21.63	17.81	14.09	-2.12	3.42	19.14	-8.44
	Traditional	13.45	10.42	16.91	6.36	-41.42	33.97	19.10	-5.29	15.78	23.45	9.25	-1.94	11.15	13.83	-8.78
	Sustainable - Traditional	23.74	7.25	30.58	-18.62	-3.51	7.10	-1.48	-3.42	5.85	-5.64	4.84	-0.18	-7.74	5.31	0.34
Taxable Bond	Sustainable	3.80	2.14	4.50	5.67	-2.28	11.25	6.37	5.20	7.06	-1.64	3.74	-0.50	3.97	3.85	-0.44
	Traditional	4.09	2.17	4.40	5.42	-2.88	11.49	7.31	4.51	6.86	-0.32	2.38	-0.35	4.07	4.10	-0.66
	Sustainable - Traditional	-0.29	-0.03	0.10	0.25	0.60	-0.24	-0.94	0.69	0.19	-1.32	1.37	-0.15	-0.11	-0.25	0.22
U.S. Equity	Sustainable	10.00	5.60	13.28	4.03	-37.68	30.63	14.75	-1.03	15.20	33.20	10.92	-2.09	10.88	19.69	-5.83
	Traditional	12.33	6.72	13.57	5.43	-37.98	30.01	18.05	-1.63	15.25	34.42	9.14	-2.15	11.87	19.04	-7.27
	Sustainable - Traditional	-2.33	-1.12	-0.29	-1.40	0.30	0.62	-3.30	0.59	-0.05	-1.22	1.78	0.06	-0.99	0.65	1.44

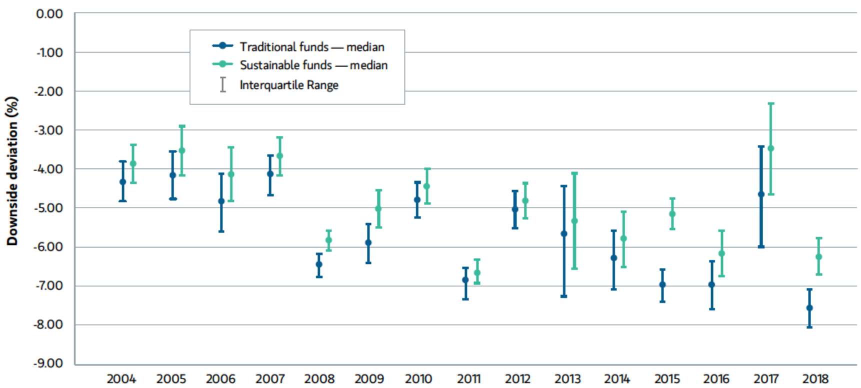
Source: Morgan Stanley, (2019). *Sustainable Reality: Analyzing Risk and Returns of Sustainable Funds*

Graph 2: Returns of Sustainable and Traditional Funds During Recent High Market Volatility (October – December 2018).



Source: Morgan Stanley, (2019). *Sustainable Reality: Analyzing Risk and Returns of Sustainable Funds*

Graph 3: Median Downside Derivation of Sustainable and Traditional Funds, 2004-2018



Downside Deviation															
Sustainable Funds	-3.86	-3.52	-4.14	-3.66	-5.83	-5.03	-4.44	-6.66	-4.80	-5.32	-5.80	-5.14	-6.15	-3.47	-6.24
Traditional Funds	-4.29	-4.16	-4.82	-4.12	-6.43	-5.87	-4.79	-6.88	-5.02	-5.66	-6.30	-6.96	-6.96	-4.59	-7.56
Difference (Sustainable - Traditional)	0.43 **	0.64 *	0.68 **	0.46 **	0.60 *	0.84 **	0.35 **	0.22	0.22 ***	0.34 **	0.51 ***	1.82 ***	0.80 ***	1.11 ***	1.32 ***
Statistical Significance	99%+	***		95%+	**		90%+	*							

Source: Morgan Stanley, (2019). *Sustainable Reality: Analyzing Risk and Returns of Sustainable Funds*

It should be clarified that not all sustainable investments yield the same results in terms of risk-return and/or benefits, otherwise we would be falling into fallacies that are not scientifically supported. Therefore, as many authors have argued, there are specific characteristics within the group of all sustainable investments. Socially responsible investments are thus subdivided into each letter that makes up the word that gives them their name: E, S and G; There is a different correlation between each of these and their corresponding corporate financial performance. Thus, out of a total of 644 cases analysed in a study comparing investments that focused on each of the factors separately versus those that combined the two letters, very promising results were obtained. Authors such as Albertini, Endrikat, Guenther and Hoppe, who had been showing in their research that the E factor (environmental) offered one of the most positive correlations (in turn assessing the existing risks to obtain objective results) in relation to their performance; the best results were achieved with a ratio of 58.7% (as positive returns achieved) compared to risks and negative returns of 4.3%[33].

Other authors such as Dalton, Guillan and Starks instead supported a very beneficial correlation in those focusing on Corporate Governance (letter G). While it is true that it was these investments that achieved the highest positive percentage among the rest at 62.3%, it was also this segment that had the highest negative results and risks (9.2%), thus placing the governance-focused investments below the environmental ones discussed above. In last place are those comprising social causes as they obtained the lowest percentile ratio in the whole study; the correlation was 55.1% positive results compared to 5.1% negative results to be considered. However, it is worth noting that the results obtained from those investments that allocated their assets around a given cause were in a better position and obtained better results than those investments that combined all ESG factors, as the same study concluded a ratio of 35.3% versus 7.1% of risk and negative results for these socially responsible investments, as can be seen in the graph 4[34].

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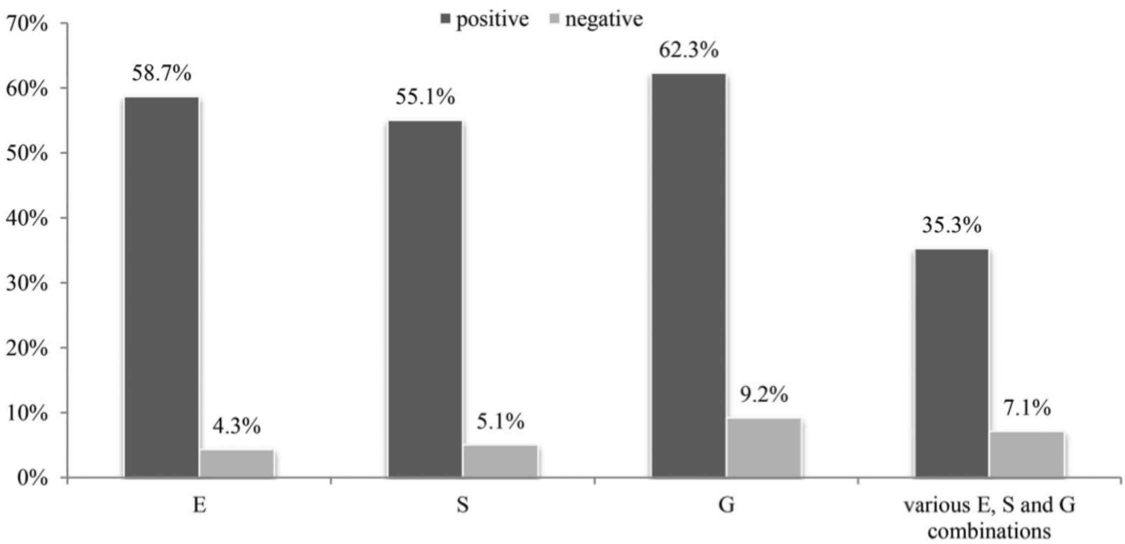
[33] Morgan Stanley, (2019). *Opus cit.*

[34] Friede, G., Busch, T., & Bassen, A. (2015). ESG and financial performance: aggregated evidence from more than 2000 empirical studies. *Null, 5*(4), 210-233.

Graph 4: E, S, and G categories and their relation to CFP .



Source: Friede, G., Busch, T., & Bassen, A. (2015). *ESG and financial performance: aggregated evidence from more than 2000 empirical studies*

4.2. Greenwashing

One of the most frequently repeated criticisms, which negatively affects the media image of the capitalist economic transition to a sustainable one, is what is commonly referred to as "Greenwahing". This term, which comes from the traditional "whitewash" or image whitening, aims to vindicate the great need and even obligation on the part of companies to show in a transparent manner all the products and services they offer to consumers, without falling into manipulations or techniques that induce customers to conceive the corporation in the way they want it to be perceived instead of what it really is. Marketing, therefore, is essential in this practice, as the aim of these techniques is to position oneself in the market in an optimal position as a result of the good reputation that is built up.

However, what this term conceals is nothing more and nothing less than a practice that is repeatedly denounced by the desire to link the brand and values of certain companies and investments with socially responsible issues in order to maintain the link with customers or investors and therefore their loyalty. However, it is not a disadvantage if certain businesses want to position themselves in a market sector that is considered greener or more socially responsible; What they cannot do is to provide misleading or exaggerated amounts of data in relation to their sustainable credentials by taking advantage of the limited regulation that currently delimits and assesses the impact of all such initiatives[35].

It is optimal from both a social and environmental point of view for companies to be involved in these sectors, as the fact that capital flows into such projects responds to the public demands that the legislator and the international community have been demanding from the private sector since its inception. However, actions integrating ESG factors should not be conceived as philanthropic actions; rather, we are faced with the search for a balance that is difficult to achieve by mixing two spheres; a) that which is focused on satisfying needs and objectives in areas that could be considered outside those of the company itself, for example in the terrestrial ecosystem through the reduction of carbon emissions or in society itself by contributing to the improvement of the education and health system; and b) the sphere focused on meeting the needs of investors in terms of competitiveness and profitability, since it should not be forgotten that the driving force behind investment projects and strategies is to be backed by a sound monetary base.

Nonetheless, there is currently a great deal of uncertainty about greenwashing and how to recognise it in the actions and statements of companies. The truth is that today there is no complete homogenisation of what is strictly conceived as greenwashing, so in the absence of such a conceptual basis, courts must carry out a case-by-case study of the factors that converge in each given case and not choose to make an analogy that would involve all potential detractors of the rules in inconsistent presumptions. Similarly, as explained above, the European Union, as one of the most influential commercial actors at international level, and whose actions therefore have environmental and social implications, has a number of environmental and social implications[36]; efforts are being made to devise a robust roadmap to distinguish where the dreaded greenwashing converges and to promote transparency of asset managers' and companies' disclosures about ESG financial products. Examples of such efforts are the recently approved EU sustainable finance taxonomy strategy or the SFDR Regulation mentioned above; however, there is still a long way to go, and this has to be done through international

[35] Alves, I. M. (2009). Green spin everywhere: how greenwashing reveals the limits of the csr paradigm. *Journal of Global Change & Governance*, *2*(1), 2-20.
[36] Lightfoot, S., & Burchell, J. (2004). Green hope or greenwash? The actions of the European Union at the World Summit on sustainable development. *Global Environmental Change*, *14*(4), 337-344.

cooperation between national authorities and regulators, as stressed by the European Securities and Markets Authority (ESMA)[37].

CHAPTER 5. CONCLUSIONS

If there is one thing that characterises socially responsible investment, it is the concept of innovation. Not only in terms of the great diversity of fields or domains that their impact can reach, but also in terms of the great variety of opportunities provided by all the facets that make up the sustainable panorama understood as such.

For all these reasons, and after analysing the main objective and subjective controversies that are commonly attributed to these types of investments, I have to admit that the sector that encompasses socially responsible financing products is a very good opportunity for society as a whole. Companies, authorities, households' income and even the ecosystem itself are witnessing the great benefits that these types of instruments bring. Starting with the security they provide in terms of profitability and risk, assuring investors highly desirable monetary returns, to the promotion of renewable energies and enabling major advances in the social, cultural and humanitarian spheres.

Far from being focused on mere idyllic and philanthropic objectives, sustainable investments constitute real opportunities that allow for a) adapt much more quickly and effectively to regulatory changes in the international financial and tax sector, which is currently heavily influenced by ESG values; b) the design of attractive and innovative investment strategies to channel the disbursed monetary flows not only into obtaining capital income but also into achieving real ESG results in environmental, health, education and other areas. In other words, we are faced with a new way of allocating portfolio assets, taking into account two fundamental pillars for improving the success and performance of investments: a long-term view on the one hand, and, on the other hand, concern for future needs (values that until now were not perceived as compatible or feasible with good economic returns); c) are a fundamental instrument to meet public demands and increase social awareness in the private sector by prioritising causes that

[37] Jones H., (2022). EU watchdog to define 'greenwashing' as sustainable funds rocket. *Reuters*. Last accessed March 2022 from: https://www-reuters-com.translate.goog/business/sustainable-business/eu-watchdog-define-greenwashing-sustainable-funds-rocket-2022-02-11/?_x_tr_sl=en&_x_tr_tl=es&_x_tr_hl=es&_x_tr_pto=wapp

were hitherto conceived as secondary, but which have proven to be equally relevant for an effective safeguarding of a competitive, healthy and stable market economy; d) expanding the number of geographic locations and markets in which these types of investments could flourish by increasing business and market volume while encouraging the revival and experimentation of hybrid market products that could be more knowledgeably tested by combined (public-private) financings, and (e) reduce risks arising from resource depletion, climate change and social risks, while at the same time increasing the profitability and performance of investments.

At first glance, it appears from the analysis we have carried out in this paper that the transition to a sustainable economy brings nothing but benefits. While this is true, and given today's highly dynamic capital markets, regulatory standards and sustainable securities, it is also inherent to conclude that there are still many steps to be taken at EU level to clarify and establish a solid basis for the sustainable landscape in the financial sector that can be extrapolated to all national jurisdictions. The absence of uncertainty coupled with the sampling of accurate data that brings transparency and objectivity to ESG asset analysis will result in increased investor confidence in the sustainable assets and projects in which they invest their cash flows[38]. In other words, there is a strengthening of the element of trust on the part of the shareholders, leading to a general improvement in the share capital itself, which, together with the reduction of the risks associated with these types of investments, will not only contribute to a long-term increase in the returns experienced, but will also lead to optimum management of the funds focused on maximising the corporations' own profits in parallel.

[38] Gerard, B. (2019). ESG and socially responsible investment: A critical review. *Beta*, *33*(1), 61-83.

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