The Paris Agreement, ESG Factors, and Investment Portfolios

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Abstract

This paper applies an event-study approach to examine the effects of the Paris Agreement on companies' ESG ratings as well as on ESG oriented investment portfolios. We adopt a portfolio approach that provides natural diversification from the unreliability of ESG ratings and subsequent reactions of individual companies to significant environmental policies, leading to more reliable estimates of ESG related performance. In the years following the Paris Agreement in 2015, we observe a significant increase in ESG and environmental ratings and stronger positive correlation between the level of ESG commitment and companies' future operating performance. Our findings show that the announcement of the Paris Agreement induced an accumulative abnormal return of long-short portfolios based on ESG rating, ranging from 1.15% to 1.32%. We further examine the effects of the Paris Agreement on the return of portfolios with different levels of exposure to climate change risk and find that the announcement of the Paris Agreement benefited portfolios which were highly exposed to climate change risks. Our findings suggest that companies are motivated to improve ESG performance during events which have high visibility and media coverage, such as the Paris Agreement. Specifically, we present evidence that post the Paris Agreement, ESG rating is better aligned with firm performance, suggesting that ESG rating is a predictor for future firm performance.

Keywords

Paris Agreement, climate policy, ESG, emission, investment returns.