

## Could facebook Face an ESG Dilemma?



**Regular readers may remember a couple of articles I wrote about ESG investing, (Environmental, Social responsibility and Governance).**

Well, Facebook (FB) is well and truly in the spotlight!

The company we all knew as Facebook changed its name on 28th October to Meta Platforms Inc. and will soon have the ticker META. However, its social media platform will keep the Facebook name. Facebook also owns Instagram, WhatsApp and Messenger, amongst others.

Facebook's sudden name change is probably a distraction from Frances Haugen and the whistleblower leaks that have marred its reputation recently. Facebook's ambitions have probably not changed though, with Zuckerberg's dream of building the 'metaverse', essentially the go-to on-line platform 'a virtual world where people can socialize, work, and play'.

But Facebook may be on the verge of being dumped by some of the largest ESG ETFs on the market, after plenty of press showing just how aware Mark Zuckerberg and other company officials are of the company's ill effects on society.

The Wall Street Journal started a deluge of investigations into Facebook in September, based on documents provided by Frances Haugen, a former Facebook Product Manager turned whistleblower. (I'd gamble she has been 'unfriended' by a few people at 1 Hacker Way, Menlo Park, CA 94025).



In the last couple of months, Haugen has testified before the US Congress and the parliaments of the U.K. and European Union, stating that the executives of FB knew for years that its platforms were having a negative impact on society, from allowing hate speech and disinformation, to inflaming body image issues in teenage girls based on internal research.

Negative press from a vast array of documents Haugen has given to the Wall Street Journal and other news outlets has only intensified the glare, although its name change and its pivot toward 'developing the metaverse' has deflected some of the criticism.

Haugen's lawyers have also filed complaints with the SEC, arguing that Meta's alleged misrepresentations to Congress and the public are also misrepresentations to investors.

More recently, Ohio Attorney General David Yost filed a securities fraud suit against Facebook, claiming the alleged misrepresentations put the state's public employees' pension at risk of losing billions in value.



Given the FB stock price fall from \$384.33 in early September to \$306.84 today (Friday 3rd December) that equates to a loss of \$214.3 Billion of market cap.

I can see why Mr. Yost and his crew are less than delighted!

## Controversy is An ESG Liability

Measuring the climate impact of a company is fairly simple. A range of sensors and tools measure emissions of greenhouse gas and other pollutants, and analysts can use those emissions measurements to determine a company's environmental footprint.

However, quantifying a company's impact on society is more about interpretation than scientific calculation.

As an example, Morningstar's 'Sustainalytics' measures ESG risk exposure of a company, and how much of that risk analysts deem is "unmanaged" by the company's management responses.

Simon MacMahon is head of research products at Sustainalytics. He said the firm's analysts aim to put an emerging issue into the broader context of whether an event is extraordinary in terms of the company and industry's history.

He suggests that Facebook has more financial risk from governments passing stricter controls on data transfer and use, rather than the wider issue of whether the company is harming society.

But the swath of evidence put forward in the press about how Facebook impacts society is a challenge to analyse.



“A lot of the information that you see in the news points to a lot of great concerns about the impact on stakeholders, the impact on society,” MacMahon said.

“It’s really not clear yet how those externalities are going to be internalized and create a business risk for Facebook.”

### **Could Facebook Be Dropped From ESG Indexes?**

Approximately 11% of Facebook’s total market capitalization is held by ETFs, according to data from FactSet, and 22 ETFs with the phrase “ESG” in their name hold the company.

Exactly how a controversy is defined, and when it becomes a big enough issue to warrant exclusion, is decided by a whole range of standards, data providers, and analysts behind them, once an index is due for a rebalance or reconstitution.

MSCI defines a business controversy as a ‘single or ongoing situation deemed by an analyst to show a structural problem in the company’s risk management that poses a risk to its operating future’, and a matrix is used to decide just how much that controversy impacts the company’s overall score.

In several ETFs under iShares’ ESG lineup, MSCI can exclude companies involved in “severe” or “very severe” business controversies, at the discretion of MSCI’s analysts.

The iShares ESG Advanced MSCI USA ETF (USXF) doesn’t hold Facebook, despite it accounting for 1.92% of the Invesco PureBeta MSCI U.S.A. ETF (PBUS)), which tracks the MSCI USA Index.

FTSE Russell’s indexes have different sets of rules based on each series of index. For example, the Vanguard ESG U.S. Stock ETF (ESGV), which tracks the FTSE US All Cap Choice Index, has a 1.96% weighting in Meta. That index screens out companies deemed to be actively flouting the UN Global Compact.

But Refinitiv, a data provider owned by FTSE Russell, uses a weighting system that reduces the controversy penalties for large companies versus small cap companies, assuming that larger firms to get more media attention than smaller ones.

The result seems to be a mishmash of approaches. Some ETFs hold a company because it is in the index, whilst others may rule out the company entirely. Other ETF managers reduce their percentage holding from the index weight. For example, the Invesco ESG Nasdaq 100 ETF (QQMG) downgraded its exposure to Facebook to 2.16% weight compared with the 3.47% weight in Invesco Nasdaq 100 ETF (QQQM).

Meanwhile, SPDR S&P 500 ESG ETF (EFIV) follows 314 companies but does not hold Facebook. That fund has gained 29.88% year-to-date, compared with the 26.65% gain in the SPDR S&P 500 ETF Trust (SPY) and its 2.05% weighting in META.

This difference in performance really presents a dilemma for fund and ETF managers. Removing the seventh-largest company in the world by market capitalization poses a threat of performance diverging from the parent index, but this can be (and is) countered by overweighting other companies within the communication services sector.

Ultimately, there is a solution, regardless of viewpoint, with SPDR and Invesco, amongst others, having ETFs in both 'for' and 'against' camps.

Despite all the grumbling from users about Facebook, its apparently arbitrary controls on individuals' opinions, and Mark Zuckerberg's imperious decision-making, it is one of the 'go-to' social networking apps, and 7th largest company globally by market capitalisation.



Perhaps we should leave it to governments and courts to decide the rights and wrongs, but if you want to avoid it, there are ETFs available from providers who agree with you.

If you are happy to hold Facebook (META), with its future vision for the 'metaverse', it may provide good returns for years to come.