Do You Know ESG?

Environmental Expectations for the Corporate World

NFP | ROUX
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Speakers

**Lauren Kim** – Senior Vice President, Legal and Technical Leader, NFP

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**Peter Kelso** – Principal, Economic & Complex Analytics (ECA), Roux Inc.

**Drew Howard** – Managing Consultant, Economic & Complex Analytics (ECA), Roux Inc.
Agenda

- What is ESG?
- The Global Rise of ESG in the Investment Community
- Climate Risk and ESG
- The U.S. Government and State and Federal Regulatory Framework
- Corporate Disclosure
- Environmental Justice
- Corporate Response and Planning
- Insurer Considerations
- Impact to Investment Community and the Public
- What does the future hold?
What is ESG?

Environmental

Social

Governance

ESG is a set of standards for a company's operations that measure its sustainability and social responsibility.

Criteria can include a company's energy use, emissions, waste disposal, pollution management and how it treats the environment.

Source: Dedalus
The Global Rise of ESG in the Investment Community

- **1963** – Clean Air Act
- **1970** – First Earth Day, Creation of EPA
- **1972** – Expansion of Clean Water Act
- **1990** – The Domini 400 Social Index was created (now the MSCI KLD 400 Social Index)
- **1992** – United Nations Framework Convention on Climate Change, also known as the Earth Summit, convenes in Rio de Janeiro and 154 countries sign into an international environmental treaty aimed to curb environmental impacts across the globe.
- **2000** – The United National Global Compact is launched.
- **2005** – Kyoto protocol entered into force.
- **2011** – The Sustainability Accounting Standards Board (SASB) is launched to standardize sustainability accounting and measurements across 77 industries.
- **2015** – Paris Agreement is brought to life, and at the United Nations General Assembly the Sustainable Development Goals were created.
ESG in Europe

• EU Taxonomy Regulation
  – Creating “green” classification system for economic activities.

Sustainable Finance Disclosure Regulation

• Requires financial asset managers to meet ESG requirements. Applies to all funds, even if they don’t sell themselves as sustainable.

Source: WSJ
Global and U.S. Sustainable Assets Under Management

ESG Global Projected AUM by Country

- Europe
- United States
- Japan
- Canada
- Australia/New Zealand

Total AUM

Years:
- 2014
- 2016
- 2018
- 2020
- 2022
- 2024

Scenarios:
- Bear 10%
- Base 15%
- Bull 20%

Bloomberg
Sustainable Investing – Fund Allocation

<table>
<thead>
<tr>
<th>Number of funds</th>
<th>U.S.</th>
<th>Rest of world</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gender and diversity</td>
<td>46</td>
<td>137</td>
</tr>
<tr>
<td>Community development</td>
<td>69</td>
<td>264</td>
</tr>
<tr>
<td>Low carbon/fossil-fuel free</td>
<td>134</td>
<td>711</td>
</tr>
<tr>
<td>Renewable energy</td>
<td>27</td>
<td>239</td>
</tr>
<tr>
<td>Water-focused</td>
<td>15</td>
<td>158</td>
</tr>
<tr>
<td>Environmental</td>
<td>111</td>
<td>767</td>
</tr>
<tr>
<td>Other impact themes</td>
<td>71</td>
<td>414</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>Assets (in billions)</th>
<th>U.S.</th>
<th>Rest of world</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gender and diversity</td>
<td>$37.2</td>
<td>59.8</td>
</tr>
<tr>
<td>Community development</td>
<td>58.3</td>
<td>102.7</td>
</tr>
<tr>
<td>Low carbon/fossil-fuel free</td>
<td>116.9</td>
<td>313.6</td>
</tr>
<tr>
<td>Renewable energy</td>
<td>19.1</td>
<td>82.0</td>
</tr>
<tr>
<td>Water-focused</td>
<td>6.1</td>
<td>75.7</td>
</tr>
<tr>
<td>Environmental</td>
<td>75.8</td>
<td>314.1</td>
</tr>
<tr>
<td>Other impact themes</td>
<td>52.1</td>
<td>167.9</td>
</tr>
</tbody>
</table>

Note: As of April 30, 2020. Some funds fall under more than one category based on the Morningstar Sustainable Investment Attributes. Source: Morningstar Direct.
Primary Drivers of ESG Growth

Institutional Drivers
- Investors
- Government

ESG Investment Strategies
- Exclusionary Screening
- Positive Selection
- Thematic and Impact (Activist) Investing

Risks / Challenges
- Lack of Standardization
- Greenwashing
Climate Risk and ESG

- Climate risk driving sustainable investing and U.S. and global regulation.
- 60% of companies in S&P 500 hold assets that are at “high risk” of climate change.
  - 80% of all large companies experience climate risk.
- Increasing pressure from shareholders and activist investors.
  - Chevron Corp is tripling spending in its new low-carbon unit.
- Supply Chain Risk
- Resiliency
  - Sea Level Rise and Adaptation
  - FEMA Flood Zones
The U.S. Government and ESG – Regulatory Considerations

- Biden Climate Plan
- Multi-pronged Agency Involvement
- ESG Task Force
- Anticipated Regulatory Framework
- State and Federal Legislation
- TRI Reporting
Biden Climate Change Plan

- January 2021 – Biden Administration Outlines U.S. Climate Policy
- Returns U.S. Participation in Global Climate Agreements
- Sets Goals For Carbon Emissions
  - U.S. Energy Carbon Free by 2030
  - Overall Reduction of 50-52% in 2005 Emissions Levels by 2030
  - Zero Carbon Emissions by 2050
- Four Prongs of Biden Strategy:
  - Stricter Environmental Standards and Regulations
  - Enforcement Mechanisms
  - Corporate Disclosure
  - Environmental Justice
- May 2021 Executive Order on Climate-related Financial Risk
• Corporate disclosure part of federal climate change agenda.
• U.S. Securities and Exchange Commission (SEC)
• ESG Task Force
• Agency Coordination – SEC, EPA, Treasury
• New SEC disclosure rule anticipated in 2021 related to climate disclosure requirements.
  – Guidance
  – Public Comments
  – Final Rule and Impact

“Investors are looking for consistent, comparable, and decision-useful disclosures so they can put their money in companies that fit their needs. Companies and investors alike would benefit from clear rules of the road.”

SEC Chair Gary Gensler
July 28, 2021
• Gary Gensler before the United States Senate, Committee on Banking, Housing and Urban Affairs, 9/14/21:
  
  – *Today’s investors are looking for consistent, comparable, and decision-useful disclosures around climate risk, human capital, and cybersecurity.* I’ve asked staff to develop proposals for the Commission’s consideration on these potential disclosures.
  
  – We’ve seen a growing number of funds market themselves as “green,” “sustainable,” “low-carbon,” and so on. I’ve asked staff to consider ways to **determine what information stands behind those claims and how we can ensure that the public has the information they need** to understand their investment choices among these types of funds.
ESG – Environmental Justice

- Environmental justice is a combination of the E&S in ESG.

- “The fair treatment and meaningful involvement of all people regardless of race, color, national origin, or income with respect to the development, implementation and enforcement of environmental laws, regulations and policies.” (EPA)

- President Biden’s environmental justice plan:
  - Establish an Environmental and Climate Justice Division within the U.S. Department of Justice.
  - Elevate environmental justice in the federal government and modernize the all-of-government approach.
  - Overhaul the EPA external civil rights compliance office.

- Mandates:
  - New monitoring in frontline and fence line communities.
  - Community Notification
  - Tackle water pollution in a science-based manner.
  - Prioritize strategies and technologies that reduce air pollution in disadvantaged communities.
Map of U.S. Environmental Justice Sites
ESG – Corporate Response and Planning

What will companies need to do?

• Understand Changing Federal Regulatory Environment
  – Disclosure Requirements / Reporting Standards

• Data Collection
  – Understand Processes
    • Potential Contaminants
    • Energy Use
    • Carbon Emissions

• Create an Environmental Management Plan
Do you know ESG?

- Review organization’s environmental goals.
- Analyze environmental impacts and legal requirements.
- Set environmental objectives and targets to reduce impacts and comply with legal requirements.
- Establish programs to meet goals.
- Monitor and measure progress.
- Review progress of system and make improvements.

Source: EPA
ESG – Insurer Considerations

- Increased Awareness by the Insurance Community to ESG Issues
- Companies That Apply ESG Values Create Less Litigation Risk Than Non-compliant Actors
- Embedding ESG Values in the Insurance Industry
  - Underwriting and Risk Management
  - Board and Association Involvement
  - Research and Data
  - Encouragement of Disclosure and Compliance
  - Investment Strategies
- Sustainable Investment Strategy
  - Excluded Markets
  - Emerging Technologies
Due Diligence
- Climate Change and Engineered Caps – FEMA Flood Zones
- Third Party Liability – Toxic Tort
- Damages to the Environment
- Environmental Justice
- Waste Disposal
- Supply Chain Analysis AKA Third Party Contractors/Suppliers “Off Shore”
- Present or Past Employees – Occupational Risk

Noteworthy
- Insurability of Emerging Contaminants/Lack of Reinsurance Support
- Insurers Reluctance to Insure “Unsustainable” Business – Perception or Reality
- Counterparty Risk and Environmental Liabilities, Insurance is a Counterparty Risk
- CAT Losses Result in CAT Payouts: Stacking of Limits

“What Would You Do in the Absence of Insurance?”
ESG – Impact to Investment Community and the Public

- ESG expected to grow over the next decade.
- Institutional and public investing.
- ERISA and 401k.
- Can circular disclosure and transparency be achieved?
  - Investment
  - Corporations
  - Government

**ESG Explodes**
S&P expects sustainable bond sales to hit $1 trillion in 2021

<table>
<thead>
<tr>
<th>Year</th>
<th>Actual Sales</th>
<th>Forecast</th>
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<tbody>
<tr>
<td>2010</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>'11</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td>'12</td>
<td>0.5</td>
<td></td>
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<tr>
<td>'13</td>
<td>0.5</td>
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<td>'14</td>
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</tr>
<tr>
<td>'15</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td>'16</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td>'17</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td>'18</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td>'19</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td>'20</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td>2021</td>
<td>$1.0T</td>
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</table>

Source: Bloomberg
Note: Issuance includes green, social, sustainability and sustainability-linked bonds globally. Forecast is from S&P analysts.
### ESG Funds Outperforming the S&P 500 in 2020

<table>
<thead>
<tr>
<th>Fund (Ticker)</th>
<th>YTD price change (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brown Advisory Sustainable Growth Fund (EAFX)</td>
<td>20.1</td>
</tr>
<tr>
<td>Nuveen Wislow Large-Cap Growth ESG Fund (WLX)</td>
<td>10.7</td>
</tr>
<tr>
<td>Putnam Sustainable Leaders Fund (PNPX)</td>
<td>10.6</td>
</tr>
<tr>
<td>Calvert US Large-Cap Core Responsible Index Fund (CSKX)</td>
<td>6.8</td>
</tr>
<tr>
<td>Ishares MSCI USA ESG Select ETF (USG)</td>
<td>6.0</td>
</tr>
<tr>
<td>Vanguard ESG U.S. Stock ETF (ESGV)</td>
<td>5.9</td>
</tr>
<tr>
<td>Green Century Equity Fund (CGRX)</td>
<td>5.0</td>
</tr>
<tr>
<td>Vanguard FTSE Social Index Fund (VFTNX)</td>
<td>4.3</td>
</tr>
<tr>
<td>Parnassus Core Equity Fund (PBLO)</td>
<td>4.2</td>
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<tr>
<td>Ishares ESG MSCI USA ETF (EESL)</td>
<td>4.0</td>
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<tr>
<td>Ave Maria Growth Fund (AVEX)</td>
<td>3.6</td>
</tr>
<tr>
<td>American Century Sustainable Equity Fund (AFGQ)</td>
<td>3.3</td>
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<tr>
<td>SPDR S&amp;P 500 Real Estate Reserves Free ETF (SPQX)</td>
<td>2.4</td>
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<tr>
<td>TIAA-CREF Social Choice Equity Fund (TISCX)</td>
<td>1.9</td>
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<td>S&amp;P 500</td>
<td>1.2</td>
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<td>DFA U.S. Sustainability Core 1 Portfolio (DFSX)</td>
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<td>Neuberger Berman Sustainable Equity Fund (NBSX)</td>
<td>-0.4</td>
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<tr>
<td>Parnassus Endeavor Fund (PAXX)</td>
<td>-3.2</td>
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</table>

Analysis limited to select U.S. equity ESG exchange-traded funds and mutual funds, with more than $250 million in assets under management, including all share classes.
Source: S&P Global Market Intelligence
What does the future hold?

- Disclosure will be mandatory for both corporate entities and financial managers.
- Companies need to understand how to collect data and comply with federal and state level regulation.
- Climate change poses significant risk at both operational and investment levels.
- Insurers and reinsurers need to assess ESG related risk.
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Thank You