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University of Houston Law Center
5th Annual North American EENR Conference

ESG and Investors

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May, 11, 2021

The Rise of ESG Investing

$17.1 Trillion

ESG Investing in U.S. at start of 2020

- ↑ **42%** growth in sustainable investing between 2018 and 2020 alone
- 33% or *one in three dollars* of total US assets under management
- **25X the level of assets in 2015**

Source: *US SIF Foundation. Report on Sustainable and Impact Investing Trends 2020*

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"Doing Good While Doing Well"

- Common misconception that focusing on ESG factors means sacrificing performance.
  - Numerous studies over various time periods have shown that companies that implement ESG criteria into their business model perform better over the longer term.
    - Recent outperformance during pandemic
  - Negative cost and risk of not implementing. *E.g.,* Environmental disasters, regulatory issues.
  - Reputational risks
  - Customer expectations
  - Investors
  - Employees
- Risk management analysis.
- Duty of care—developing view that focus on ESG considerations is a part of fiduciary duties.

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"E" is for Environmental Considerations and Compliance

- Considers a company's use of natural resources and the effect of its operations on the environment, both in its direct operations and across its supply chains.
- A Company's environmental management system and how effective it is with respect to compliance with laws and reducing the impacts or adverse effects to the environment.
- The environmental factor examines a company's environmental disclosures, impact and efforts to reduce impacts to the environment.
- Tangible risks for shareholders and stakeholders.

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“S” is for Social

- How a company manages relationships with its employees, suppliers, customers and communities where it operates.
- Some of the questions asked include:
  - Does the company work with suppliers that hold the same values as it claims to hold?
  - Does the company donate a percentage of its profits to the local community or encourage employees to perform volunteer work there?
  - Do the company’s working conditions show high regard for its employees’ health and safety?
  - Are other stakeholders’ interests taken into account?
  - Does the company hold Diversity, Equity and Inclusion (“DEI”) in high regard with respect to who it hires into its workforce, who it chooses as its suppliers, how it decides how its product or services for its customer base, and whether it regards the needs of the community in which it operates?

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“G” is for Governance

- A company’s leadership, executive pay, audits, internal controls and shareholder rights.
- Investors may want to know that a company uses accurate and transparent accounting methods and that stockholders are given an opportunity to vote on important issues.
- They may also want assurances that companies avoid conflicts of interest in their choice of board members, don't use political contributions to obtain unduly favorable treatment and, of course, don't engage in illegal practices.
- DEI plays a significant role in this space, as well.
- Most recently, on December 1, NASDAQ is pushing to require the thousands of companies listed on its exchange to include women, racial minorities and LGBTQ+ individuals on their boards.

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Where do ESG requirements come from?

- Increasing regulatory and governmental focus on the federal, state and local level. For example, CA and Illinois statutes, recent Texas legislation relating to energy companies
- ESG pressures "wholistic"– multiple non-regulatory sources
  - Investors, employees, customers, clients, ratings agencies, proxy voting firms
- SEC/DOL
  - SEC focus on ESG topics, including disclosure
  - DOL shifting view on ESG considerations for ERISA plan investments
- Developing regulation, *e.g.*, recent NASDAQ proposed diversity standard
- Worldwide initiatives such as the UN Sustainable Development Goals

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UN Sustainable Development Goals

- Set in 2015 by the UN General Assembly
- Intended to be achieved by 2030
- Designed to be a “blueprint to achieve a better and more sustainable future for all”

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Investor Expectations

- Different types of investors have different expectations.
- Analyze factors such as climate risk, board quality or cybersecurity and how impact financial value in a positive or negative way.
- Engagement very important.
- Report to shareholders—concise communication of how organization’s strategy, governance, performance and prospects in context of external environment lead to creation of value.
- Actual implementation of measurable targets. Plans and updates on how being implemented and success rates.
- Program should be targeted to specific business/industry.
  - Materiality—focus on material issues for your business that impact valuation. For example, greenhouse emissions relevant for an electric utility company but not for a financial services firm.
  - For example, a company with environmental impact cannot ignore the “E” while focusing on the “S” or “G”.
  - Pressure on supply chain partners.

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Sources of Information

- Sustainability Accounting Standards Board (SASB)
- Company filings, reports
- Ratings agencies—*e.g.*, S&P industry rankings
- Investors own research—from publicly available information, including press
- Reporting tools—increasing amounts of information available

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For more than twenty years, Stacy has represented registered investment companies and their independent directors and investment advisers-- counseling them on a broad range of matters relating to the operation of investment companies of all kinds, including: the organization and offering of open-end and closed-end funds and ETFs; mergers of individual funds and fund complexes; and board governance, compliance and other regulatory matters under the federal securities laws. Stacy regularly counsels on topics such as compliance, distribution, risk management oversight, and on new regulatory and industry matters.

She has substantial experience relating to registered fund products, including ESG, impact and socially responsible funds, umbrella series trusts, alternative investment funds, variable annuity insurance funds, funds of funds and manager of managers structures. She is also known and has been recognized nationally for counseling fund boards.

Stacy has been recognized nationally in the area of mutual/registered fund law and was also named a "2019 Notable Woman in Law" by *Crain's New York Business*. She is a member of the Advisory Panel for *Fund Directions*. Stacy is a regular speaker and writer, and is frequently quoted, on topics such as ESG, board governance, fund best practices and cybersecurity.

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