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ESG Investing to Continue Growth in 2021 under Biden Administration

Environmental, Social and Governance ("*ESG*") investing in the United States has reportedly reached an estimated $250 billion in assets under management and is expected to see continued growth in 2021 and beyond. ESG investing occurs when investors make investment decisions based on a company's environmental, social and governance policies alongside traditional financial metrics. Unlike traditional socially responsible investing where investors are only concerned with the social impact of the investment, ESG investors are dually focused on increasing returns and minimizing risk under the premise that companies that focus on ESG criteria in their operations will ultimately perform better thereby maximizing shareholder value.

Investment firms, institutions lending on ESG investments, and individual investors are increasingly looking at ESG factors to identify material risks and growth opportunities, and, as a result, several variations of investment vehicles have emerged over the past several years. Green bonds, which are bonds for financing environmentally friendly projects such as renewable energy and clean transportation, were first issued in the United States in 2010. In 2012, participants executed the first social impact bond (also known as pay for success financing) transaction, with the goal of reducing recidivism at Rikers Island jail complex. In a pay for success financing, private investment is used to fund a social program. If the social program achieves a pre-determined level of "success," the savings generated by the government as a result are used to repay the investors. More recently, social bonds that finance projects with positive social incomes (like food security and access to education) and sustainability bonds that fund a combination of both green and social projects have been issued. In June 2020, the Ford Foundation issued $1 billion of social bonds to support nonprofit organizations impacted by the COVID-19 pandemic, and, in February 2021, JPMorgan Chase issued $1 billion of social bonds to fund affordable housing projects. Also, in February 2021, Goldman Sachs issued $800 million of sustainability bonds to accelerate climate transition and advance growth in other environmental issue areas. In May 2020, Bank of America issued $1 billion in COVID-19 Bonds with the specific purpose of funding nonprofit hospitals engaged in the COVID-19 battle.

In addition to these debt instruments, investors can deploy their capital through investment funds that apply ESG principles. According to a recently released Morningstar report, both the number of sustainability-focused index funds, and their assets, have doubled over the past three years. And, specifically in the United States, assets in sustainable index funds have quadrupled in the last three years and now represent 20% of the global total. These ESG funds captured $51.1 billion of net new money from investors in 2020.

Beyond debt instruments and investment funds, some banks are making green loans to borrowers to finance specific environmentally friendly projects (including renewable energy projects), and industry groups have developed a set of green loan principles relating to such loans. Financial institutions are also lending funds to borrowers using sustainability linked loans or social loans where the interest rate on the loan is linked to meeting pre-defined ESG performance targets. The loan proceeds themselves are not required to be used to finance social or green projects, but the interest rate on the loans is tied to the ESG performance of the borrower.

The current rise in ESG investing, which was fueled in 2020 in part by strong performances of ESG-focused companies during the COVID pandemic, is expected to expand even further as the Biden administration takes a stronger national stance on these issues. For example, President Biden recently signed an Executive Order putting the climate crisis at the center of the United States' foreign and national security policy, including by rejoining the 2015 Paris Agreement to curb greenhouse gas emissions. Furthermore, the Biden administration has been clear that ESG-related disclosure will be a focus of this administration's Securities and Exchange Commission (SEC). The SEC is already reviewing climate change disclosures, and the Commission's Investor Advocate recently issued an ESG investor bulletin. It is also expected that new leadership may affect a recent rulemaking by the Department of Labor governing the incorporation of ESG considerations into retirement portfolios subject to the Employee Retirement Income Security Act (ERISA). The administration has also signaled that specific climate-related risk requirements and guidance for financial institutions may be forthcoming and banking regulators, including the Board of Governors of the Federal Reserve System and the New York

State Department of Financial Services, have already taken steps to assess climate risks.

Many investors have developed, or are in the process of developing, ESG policies to provide a framework for measuring the sustainability and societal impact of a particular investment and ultimately guiding them in the determination of whether an investment is warranted. In evaluating ESG performance, investors and lenders conduct additional in-depth diligence on issues such as climate change, water management, sustainability, human rights, diversity and inclusion, supply chain management, and corporate transparency. Currently, there is not a single standard for rating a company's ESG performance. Rather, numerous institutions are working to form standards and define ways to include these factors into the investment process. These include the Sustainability Accounting Standards Board (SASB), the United Nations' Principles for Responsible Investment (UN PRI), the Equator Principles, the Global Reporting Initiative (GRI) and the Task Force on Climate-Related Financial Disclosures (TCFD). In addition, the Loan Syndications and Trading Association (LSTA) has developed an ESG Diligence Questionnaire and issued guidance documents, such as Sustainability Linked Loan Principles, to assist lenders in obtaining reliable ESG information on borrowers in the loan market.

The landscape for ESG investing is sure to shift during the coming months and years with regulatory developments, introduction of new investment vehicles and clarity with respect to measuring ESG performance. Chapman and Cutler LLP attorneys will provide updates as these changes take place.

For More Information

Please contact Amy Cobb Curran, Kristin Parker, the Chapman attorney with whom you regularly work, or visit our Social Finance and Impacting Investing resources at chapman.com.

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