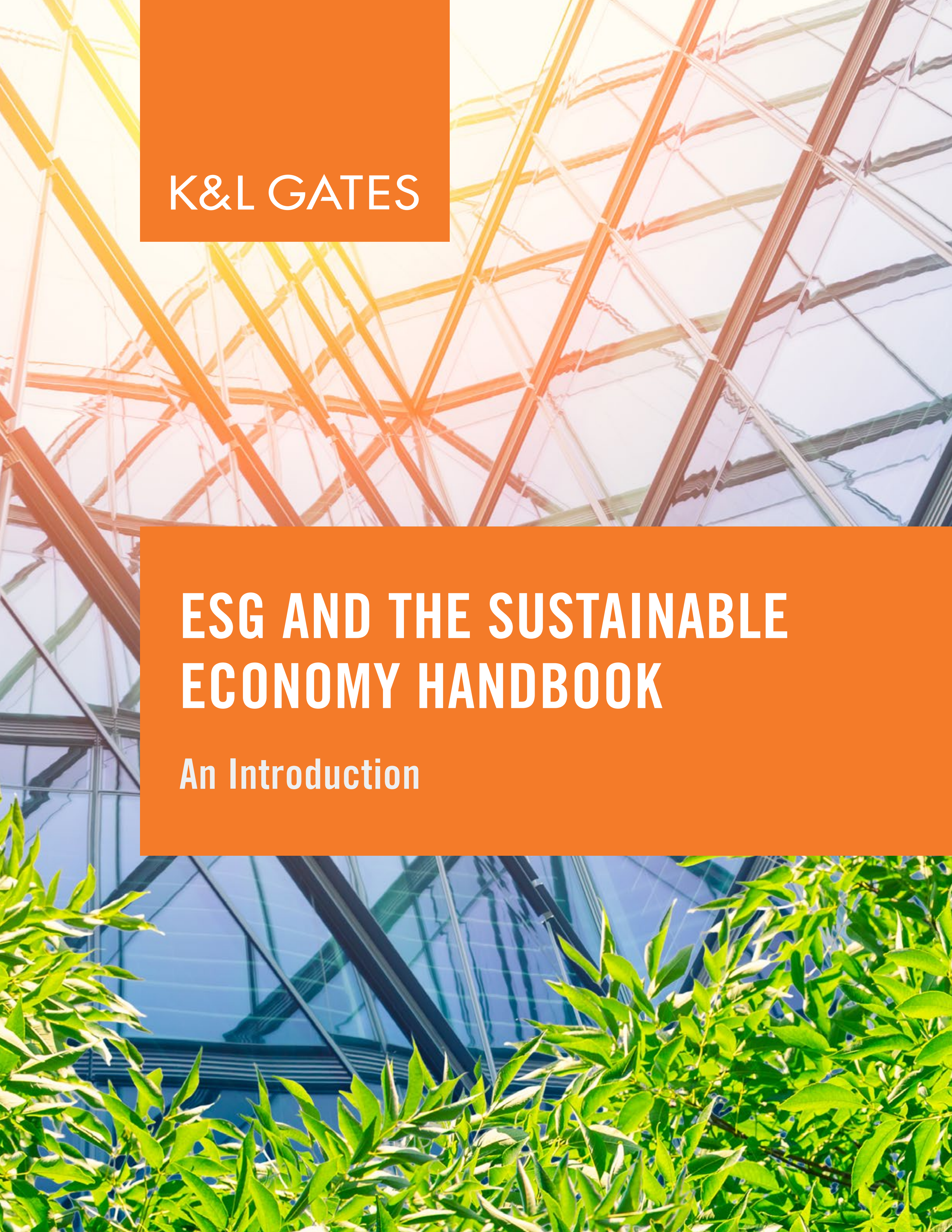

K&L GATES

ESG AND THE SUSTAINABLE ECONOMY HANDBOOK

An Introduction

INTRODUCTION

While environmental, social, and governance (ESG) is a broad concept that means somewhat different things to different people, it is ultimately an investment ethos whereby certain criteria that may not be neatly quantifiable are accounted for in evaluating an investment target. These factors fall into one of the three ESG categories, which at a high level, generally take into account the following:

Environmental factors are typically concerned with calculating the direct and, in some cases, indirect impact of a business on the natural environment. The business's efforts to conserve or improve the natural environment may also be considered.

Social factors consider how a business handles its relationships with suppliers, contractors, employees, and communities. As such, it is inherently focused on labor practices and community relations.

Governance factors are focused on how a business is managed and operated, executive compensation, shareholder rights, and how the target holds itself accountable, such as through audits and internal controls. Recently, some investors have also begun to consider how a business is structured, for example, whether the business qualifies as a public benefit corporation or utilizes tax havens in their corporate structure.

It can be difficult to evaluate and compare the various frameworks for scoring ESG criteria. While some are publicly available, most businesses treat their frameworks as confidential, along with the facts evaluated in the scoring process. Nonetheless, several guidelines and initiatives are more broadly available to help businesses think about ESG criteria. One example, the Principles for Responsible Investment, is widely used by institutional investors. In addition, some investors who choose to consider ESG criteria are subject to requirements that impact their approach. Among them are requirements imposed by public markets, such as Euronext, and government-imposed restrictions, such as those applied to U.S. pension plans.

How and to what extent investors take ESG factors into account varies. Investors may incorporate ESG factors into their overarching analyses of potential investments or include an ESG score determined by a third-party analyst among the factors weighed as part of their investment decisions. Investors may even select investments based in large part on their ESG score, although in the current market, this approach may be seen more as impact investing than standard investing practice.

In recent memory, ESG matters were primarily of interest to larger investors, but this is no longer the case. Over time, investors using ESG criteria have made a significant impact in how they invest their money. As that process has continued, certain industries have risen to the top in conversations about ESG. As a result, participants in those industries and others have begun to consider and incorporate ESG-related factors into their businesses in a more holistic way rather than limiting the consideration of these factors to an investment context.

This holistic focus on ESG factors in all areas of finance and business is rippling across and within industries. Companies receiving investments from ESG-minded investors have incorporated ESG-related policies into their supply chain management, relationships with contractors, and internal decision-making. Moreover, while in the past ESG concepts have often been considered separately from each other, businesses are now beginning to think of the individual concepts collectively as they move toward analyzing decisions in the context of working toward a sustainable economy.

What is a sustainable economy? This concept is independent of and broader than ESG, but many of the same concepts flow through both of them. Both are concerned with environmental sustainability and security, ethical labor practices, equity and inclusion, and corporate governance that takes a long and broad view of success. However, efforts to create a sustainable economy go beyond risk analysis to consider the steps needed to create micro and macro economies that are as sustainable as possible in environmental, social, and financial terms for the benefit of investors, employers, employees, well-served and underserved communities, and the natural environment. Thus, the sustainable economy encompasses ESG investment philosophies, stakeholder capitalism, community capitalism, environmental justice, and several other concepts oriented toward taking a longer view of our people, planet, and prosperity.

Because ESG and sustainable economy considerations are increasingly popular and widespread, we look forward to providing updates and supplements to this handbook as the global conversation evolves. In the meantime, we hope it will serve as a helpful launching point for ongoing discussion.

This handbook addresses ESG and the sustainable economy as related and often interwoven and overlapping concepts. Here, we bring together high-level discussions of the investor’s evaluation process, the operator’s incorporation of criteria oriented toward these principles, and many of the legal and financial considerations that affect both groups. To do that, this handbook considers investment from four angles:

OVERVIEW

Provides a more in-depth discussion of some of the hot topics in current conversations around ESG and the sustainable economy, considerations for creating an internal sustainability policy and procedures for implementation, and trends in ESG and sustainable economy-oriented public policy actions.

PERSPECTIVES IN ESG INVESTMENT

Discusses how ESG investment may be considered by investors, managers of publicly traded and privately traded investment vehicles, and Employee Retirement Income Security Act (ERISA) funds. It also addresses several regulatory considerations, from passive versus active ESG investment to greenwashing.

KEY OPERATIONAL CONSIDERATIONS IN THE SUSTAINABLE ECONOMY

Begins with a high-level overview of the sustainable economy and then highlights many of the industries that are at the forefront in conversations about ESG and the sustainable economy, from water resource development and affordable housing to renewable energy and microfinance. This section focuses on the importance of these industries in the context of the sustainable economy and some of the high-level legal considerations that are most pertinent to this analysis.

INCENTIVES AND OTHER FUNDING TECHNIQUES IN THE ESG SPACE

Explores many of the financing methods and industries generally discussed in the context of ESG investment. Topics range from industry specific instruments, such as virtual power purchase agreements, to variations on more generally applicable instruments, including green bonds and wind futures. This section also includes brief discussions of the role that tax and other government incentives play in key industries.

K&L GATES