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SEC SIGNALS INTENTION TO ENCOURAGE INCREASED ESG INVESTING, POSSIBLE GUIDELINES

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The current SEC Commissioner, Allison Lee, recently signaled the agency's desire to encourage financial institutions to consider environmental issues when evaluating their investments. Identifying climate change as a specific and increasing threat to the U.S. economy, the Commissioner called for more regulated disclosures of environmental, social, and corporate governance ("ESG") risks, particularly with regard to financial institutions known to invest in fossil fuels.

Lee identified climate change as a systemic risk that can present irreversible market changes. A large climate event can cause dramatic changes to the pricing of assets. Affected industries may see their business models become obsolete overnight, as has been the case on specific industries in the wake of the coronavirus pandemic.

Managing these risks involves better and more standardized definitions of what "green," "sustainable," or "ESG-focused" funds mean. Establishing an industry-wide consensus on what it takes to market funds using these terms will allow everyone to better weather the demands of an economy subject to climate change. Other steps include developing a standard means of evaluating credit rating agencies based on their approaches to climate and ESG risk, and mandatory disclosures of direct and indirect greenhouse gas emissions associated with financing.

Big Banks and Sustainable Finance

Some institutions have already taken steps to meet the demands of a climate-effected economy. GHG emission disclosures and other ESG related disclosures have been gaining in popularity for nearly ten years, but a standard rubric for classifying funds as "green" or "sustainable" has not yet been established. SEC seeks help from market participants to set new initiatives and rulemaking efforts.

Only about 50% of major banks have issued a public statement of commitment to sustainable finance. Though a public commitment does not in and of itself constitute an institution's dedication to sustainability, the public statement is still important because: (1) it encourages customers to approach banks to finance low-carbon projects; (2) it encourages bank employees to seek out opportunities to support sustainability; and (3) it encourages other banks to follow suit in their own businesses.

A means of evaluating an institution's commitment to sustainability is to assess how much a "green" target represents a new allocation of capital. In other words, how much more money is a bank investing in green targets than it has in the past, and how does that compare with, for example, the amount the bank still invests in fossil fuels. Most major banks still invest more heavily in fossil fuels than they do in sustainable investment. However, this tendency is changing, with many of the largest banks attempting to at least reach a balance between sustainable and fossil fuel investment. The banks on the smaller side appear to be in some cases nimbler in incorporating these changes, as seen below.

Bank of Montreal

The Bank of Montreal is notable among larger banks because it has, since at least 2016, invested significantly more money in sustainable investments than in fossil fuels. Whereas many major banks—particularly the larger ones—are moving slowly toward a balance in the amount of money invested in sustainable projects and fossil fuels, the Bank of Montreal has already established a portfolio with annualized sustainable investments at $44.1 billion and an average annual fossil fuel finance $18.86 billion—a more than 2 to 1 ratio in favor of sustainable finance. The Bank of Montreal has also been carbon neutral since 2010, and seeks promotes ESG best practices in the companies in which they invest.

Goldman Sachs

Goldman Sachs established an Environmental Policy Framework to address climate-change and its effect on the economy in 2005. Since then they've sought to encourage economic growth by investing in technological innovations in clean technology, resource efficiency, and growing a shared, connected economy. They have:

1. become the first large U.S. bank to place explicit restrictions on financing for for any part of the oil-and-gas sector;
2. set a goal to expand clean energy project financing to $150 billion by 2025;
3. established an annual "Carbonomics" forum of key stakeholders and policymakers to share strategies for decarbonizing the economy and encouraging sustainable growth;
4. worked with the Conservation Fund to finance the purchase of forest lands, thereby saving these tracts from development. The Conservation Fund uses forests for both economic growth and sustainability purposes—it requires all projects on its lands to plant more trees than they harvest;
5. established an initiative to bring clean energy solutions to underserved markets;
6. created new financial products to help clients manage climate-related risks, including weather-related catastrophe bonds and investments in infrastructure resiliency; and
7. adopted a climate approach in its operation, including minimizing its operational impact on climate change. This includes achieving carbon neutrality of its own operations as of 2015, achieving its 2020 goal of green building certification for 70% of the firm's global real estate portfolio; and establishing a target of 100% renewable power for its electricity needs as of 2020.

Morgan Stanley

Morgan Stanley established the Institute for Sustainable Investing to build finance solutions that have competitive financial returns while simultaneously driving environmental and social changes. They have also:

1. announced it will be the first U.S. bank to measure and disclose greenhouse gas emissions related to its lending portfolio;
2. set a goal to reach net zero financed emissions by 2050; and
3. devoted proceeds to support affordable housing in vulnerable communities.

The Morgan Stanley Institute for Sustainable Investing found that enthusiasm for impact investing is at an all-time high; however, only a little more than half of investors have actually begun to take sustainable investing actions. Some of the reason for this may be that identifying sustainable investments has not been facilitated until recent years. As more companies offer ESG search tools and publicly state their sustainable goals, the investment percentages are likely to increase.