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CORPORATE SUSTAINABILITY IN THE UNITED STATES AND IMPROVING YOUR “CORPORATE PROFILE”

By Douglas Lashley

Overview

We must recognize that we are all part of a world that is entirely reliant on the natural environment to live and do business. It is also pretty clear that as a world we have wreaked havoc with our natural resources and that in most countries our economic systems assume an infinite supply of raw materials including both air and water and the biodiversity system they support. The world also assumes an infinite supply of energy and that the unlimited supply of these raw materials allows limitless production, significant growth in consumption annually and boundless sinks for disposing of the waste we produce. As I write this article the world’s population grows and dependency on energy increases. Why or how? By 2040, only 26 years from now the global economy is supposed to be about 130% higher than in 2010. Projections suggest another 2 Billion people will inhabit the planet. Just in the Chesapeake Bay Region on the East Coast of the United States, a geographic footprint system which includes just 5 States including Washington D.C. it is estimated the population will go from 17 million today to 24 million people by 2060.

A majority of humans know, appreciate and can connect with land and water. We love lakes, streams, oceans and the mountains. We appreciate the fact that these resources can be a sanctuary where we find peace of mind in the ever turbulent world in which we live. We understand we need to build houses, improve and enlarge highways, deepen ports, explore the world for more sources of energy, farm, cut timber to produce wood products etc. But how can we sustain this type of activity in light of the negative impact it has had on our resource values? This paper discusses the role of corporate America in this endeavor and how we can find a balance between economic stability, growth and maintaining environmental quality.

The Regulatory Framework and ESG

Even though the likelihood of federal legislation is vastly diminished from its peak in 2008, climate change is becoming an increasingly contentious and public issue for companies like public or investor-owned utilities that emit carbon and utilize natural resources as part of their core business operations. It’s not just the public that is taking a closer look at these companies; investors, too, are incorporating sustainability analyses into their evaluation of equities’ risk factors and long-term financial prognoses. In 2010 the Securities and Exchange Commission (SEC) issued official guidance regarding public corporations’ disclosure of material information related to climate change and greenhouse gas emissions. This release marked a pivotal moment in the so-called Environment, Social and Governance, or ESG, investing movement because it was the first time a regulating body in the U.S. recognized the financial impact of environmental and climate related risks on publicly traded companies. Establishing real and substantial environmental sustainability programs that effectively mitigate the effects of carbon emissions, from both a scientific and a public relations perspective, play a critical role in adapting to this new and intense scrutiny.

An important aspect of ESG analysis is natural resource management. Natural resources also referred to as “ecological assets,” provide functions and values collectively known as “ecosystem services.” The use of ecological assets to create, restore, enhance and preserve ecosystem services forms the basis for credit generation and trading in the form of mitigation banking. Mitigation banking is a market-based practice typically used by real estate, energy, public utility and transportation infrastructure industries to provide compensatory mitigation for impacts to natural resources like wetlands, forests, streams and endangered species. But use of advanced compensatory mitigation in the form of banks can also be successfully adapted to suit the needs of companies seeking to establish or enhance their sustainability profiles. One strategy for increasing corporate social, economic and environmental returns is utilizing an investment in a conservation oriented mitigation bank. Investors and other corporate

stakeholders in the U.S. are starting to evaluate this type of investment in order to meet certain sustainability standards imposed by Board directives and to enhance corporate reputations.

CLIMATE RISK

According to the Earth Policy Institute, carbon emissions from fossil fuel production are at an all-time high. After a small dip due to the global economic slowdown, global emissions hit 9.7 billion tons in 2012 with 1.4 billion tons emitting from the United States alone.¹ Despite the fact that climate legislation is no longer imminent, federal action does appear imminent with President Obama's recent directive that the EPA begin to create new, stricter emissions rules for coal-fired power plants.

Investors are not taking this lightly and are looking to companies to incorporate climate change into their risk management practices. The Pinchot Institute even reports that health care companies who you would think have little impact on environmental quality do admit and recognize they a) employ hundreds of thousands of people nationally; b) provide buildings, construct and operate hospitals to house their workers which in turn utilize a lot of energy and c) these employees burn gas to commute and in short contribute to poor environmental quality. Even this industry has sought to offset their carbon discharges by investing in carbon sinks such as tree farms. One such program in Corvallis, Oregon is known as Forest Health = Human Health. It is a voluntary program undertaken by that industry in Oregon and encourages restoration and maintenance of forest systems.

THE ESG INVESTMENT APPROACH

Creating economic value in our natural ecosystems is one of the most powerful motivators for sustaining them. Once we start thinking about ecosystems as assets, environmental sustainability can become part of the economic fabric of society. Conservation will be embedded in business activity – leading to an economic model that supports growth in a way that also is in harmony with nature.

The ESG approach allows investors and financial institutions to quantify environmental, social and corporate governance activities in order to better grade a company's long-term financial health and better manage the investors' risk. This approach is permeating all aspects of institutional investment and is being advanced by the industry's largest players.

INSTITUTIONAL INVESTORS

Investors in both Europe and the United States are augmenting their investment approaches to feature a strong emphasis on sustainability. In Europe, in particular, raising large amounts of equity without established sustainability programs is increasingly difficult and, as U.S. firms seek European investment they, too, are being asked tough sustainability questions. A 2012 study by EuroSIF, the European Sustainable Investment Fund, found that "Sustainable investments by Europe's wealthiest investors have increased by nearly 60% over the past two years, compared to an 18% increase in overall European high net worth wealth over the same period."²

This increased attention is crossing the Atlantic and permeating the U.S.'s largest investors, as well. In 2012 the California Public Employees Retirement System (CalPERS), the nation's largest pension fund with 1.6 million members and a market value of \$257 billion,³ issued its first ever sustainability report. The report focuses on the ESG model and stresses that while each of the three facets has an aspect of social responsibility, CalPERS is

¹ [Earth Policy Institute Website](#)

² [Investment Europe Website](#)

³ [CalPERS Website](#)

adapting its business model in order to effectively mitigate risk and increase return. Nowhere is this truer than with regards to the report's environmental approach:

“Environmental issues, and climate change in particular, pose a set of enormous risks and opportunities for CalPERS. Climate change has an increasingly large influence on the energy and water strategies used by our portfolio companies, making it an important fiduciary consideration in our investment process.”⁴

This report was an attempt by the fund's leadership to weave sustainability into every aspect of its investing approach. Of course, CalPERS does not directly invest in these projects, instead deploying its money through a vast network of portfolio managers. This downward pressure has forced fund managers and analysts to incorporate ESG principles into their daily investing strategies.

THE FINANCIAL DATA INDUSTRY

Most financial institutions deploying the institutional investors' funds now employ a team of ESG analysts who advise portfolio managers. These analysts rely on the information provided by companies like Bloomberg and Thomson Reuters to quantify ESG activities so that managers can incorporate it into their investment strategies.

- **Bloomberg:** Bloomberg boasts that it “provides data on more than 120 indicators for approximately 5,000 publicly-listed companies globally, and is increasing coverage every day. Bloomberg also provides sustainability news, research, indices, funds, energy & emissions data, legal & regulatory as well as robust screening, scoring and other portfolio optimization tools.”⁵
- **Thomson Reuters:** In November of 2009, Thomson Reuters announced the acquisition of ASSET4, the leading provider of ESG data. ASSET4 gathers extensive, objective, quantitative and qualitative ESG data more than 4000 global companies and scores them on four pillars: Environmental, Social, Corporate Governance, and Economic. In turn, the pillar scores form the basis of an overall company score summarizing a company's strength in adhering to ESG principles.

CREDIT RATING AGENCIES

Of the so-called Big Three credit rating agencies (S&P, Moody's and Fitch) only S&P formally publishes sustainability measures. S&P sister company, Dow Jones, operates the Dow Jones Sustainability Index (DJSI), launched in 1999, as the first global sustainability benchmark. The indices track the stock performance of the world's leading companies in terms of economic, environmental and social criteria. The indices also serve as benchmarks for investors who integrate sustainability considerations into their portfolios, and provide an effective engagement platform for companies who want to adopt sustainable best practices.

The DJSI bases its ESG assessment on an online [questionnaire](#) supported by extensive company documentation. Thorough analyses of company-specific information are complemented by an additional examination of media coverage, stakeholder commentaries and other publicly available sources.

The questionnaire features about 100 questions on economic, environmental and social issues with a focus on industry-specific criteria that have a material impact on companies' ability to generate long-term value. The CSA is regularly updated and adapted to capture new sustainability trends that are at the forefront of each industry sector

⁴ [CalPERS Website](#)

⁵ [Bloomberg Website](#)

and that are likely to have an impact on companies' competitive landscape. A sample of the questionnaire is attached and the environmental portion can be found on pages 23-30 of the PDF.⁶

MITIGATION BANKING⁷

In the United States Mitigation bankers sell mitigation credits to permittees and others who must compensate for impacts to water resources and other natural resource amenities. Mitigation credits are established under Federal and State rules that reward a party for restoring and permanently preserving environmental quality and biodiversity in acreage that had historically been impacted by some activity adverse to environment quality.

Three popular types of mitigation banks include:

- **Wetland/Stream Banks:** These banks offer credits that satisfy regulatory compliance for Section 404 of the federal Clean Water Act, and other State and local regulations, for mitigating unavoidable impacts to wetland and stream resources.
- **Conservation Banks:** These banks offer credits that satisfy regulatory compliance for Sections 7 and 10 of the federal Endangered Species Act, and other State and local regulations, for mitigating unavoidable impacts to threatened and endangered species and their habitats and other sensitive habitat areas.
- **Nutrient Banks:** These banks offer credits that offset water quality impacts (phosphorous, nitrogen and sediment) from point source and non-point source polluters, such as wastewater treatment plants and agricultural fields, respectively. These credits satisfy regulatory compliance for Clean Water Act's Total Daily Maximum Load (TMDL) requirement.

There are approximately 1,100 wetland, stream, forestry and nutrient mitigation banks currently operated across the United States. Mitigation banking is also expected to play a critical role in implementing President Obama's May 2013 Presidential Memorandum directing federal agencies to expedite permitting relating to key infrastructure projects. The Memo follows a March 2012 Executive Order, which instructed federal agencies to review the permitting process to increase efficiencies:

“Through the implementation of Executive Order 13604 of March 22, 2012 (Improving Performance of Federal Permitting and Review of Infrastructure Projects), executive departments and agencies (agencies) have achieved better outcomes for communities and the environment...by implementing best-management practices. These best-management practices include...utilizing landscape and watershed-level mitigation practices.”⁸

Mitigation bank projects help restore numerous biodiversity benefits the most common of which include:

- **Carbon Sequestration:** While the main purpose of most banks is to restore and reestablish wetlands and improve water quality in areas degraded by human activity, an added benefit is the project's ability to function as an effective carbon sink. An article in the July-August issue of *the Journal of Environmental Quality* noted “two 15-year-old constructed marshes in Ohio accumulated soil carbon at an average annual rate of 2,150 pounds per acre -- or just over one ton of carbon per acre per year.”⁹ An average 400 acre agricultural site involving newly

⁶ [RobecoSAM Website](#)

⁷ [National Mitigation Banking Association Website](#)

⁸ [White House Website](#)

⁹ [eScience News Website](#)

restored and fully functioning wetlands, has the potential to claim credit for as much as 6,224 tons, or 12.5 million pounds, of carbon sequestration over the next 15 years.

- **Improved Water Quality:** A typical wetland restoration banking project is also estimated to reduce nutrient pollution by including reduction of nitrogen, phosphorus and sediments over the perpetual life of the project. The calculation in pounds of each load reduction is based in large part on site specific conditions, methodologies and technology employed to reduce loads, and certification methods use by the jurisdiction where the property is found.
- **Species Habitat Restoration:** The restoration of the riparian headwater system through the planting of native trees and plants and the stabilization of streambeds not only improves water quality but also provides habitat for native species. A number of avian and mammalian species typically return to these restored systems thereby enhancing their survival and potential for long term reproduction.

CONCLUSION

Environmental risk is at an all time high for companies that rely on natural resources like those in the transportation, energy and infrastructure development industries. Even an industry that we think would be fairly benign such as the health services industry has evaluated the need to offset their impacts to address sustainability issues. Climate change and greenhouse gas emissions are certainly priorities, but Wall Street analysts and investors also consider land use and water quality important risk factors that should be mitigated. Investing in advanced compensatory mitigation where forests are re established and polluted waterways are restored is a means to mitigate those risks. These unqualified on-the-ground environmentally successful projects can result in proven enhancements to water quality, habitat restoration and produce carbon trapping ability. These projects can offer unique opportunities to offset elements of environment risk while improving a company's overall sustainability profile with investors. Even if the investment is made based on a non permitting related activity the company is investing in a result where its consumer and investor stakeholders will hold it in higher regard. This is because Wall Street historically views more favorably those companies that have a good environmental standard than a poor one. So does the buying public.

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