Green Investing: A New Focus for Plan Sponsors and Institutional Investors

The term "green" investing is often used interchangeably with "environmental investing" or "sustainable" investing, but for purposes of this paper, we will use the term "green."

During the nearly six-year period between December 2005 and March 31, 2011, U.S. investment assets characterized as "green" grew over 315 percent to $2.20B, a five year annual growth rate of 31 percent.[1] Even during the time period from 2008 to late 2010, when the world experienced a protracted global economic downturn, growth in green assets remained strong.

The steady climb in green assets suggests that what was once primarily a peripheral investment strategy is moving into the mainstream and gaining traction as a viable investment solution.

In this paper we will define what it means to invest in green today and discuss the rationale for the growing interest in this space, outlining the academic and investment cases for the retirement and institutional investor.

GREEN INVESTING—AN OVERVIEW

At its simplest, green investing entails evaluating potential investments from both a financial and environmental performance standpoint, focusing on the risks and opportunities to a company's bottom line. Analysts research how issues like climate change, water scarcity, pollution, and waste management impact the company's overall profitability.

Green investing has its roots in a fairly narrow, values-driven investment philosophy that focused on excluding companies from investment consideration—regardless of financial performance—if they were believed to be part of the environmental problem. Green investing has also come to include so-called "pure-play" companies engaged in environmental initiatives such as manufacturing smart electrical meters that help consumers save energy.

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But in recent years, investors looking for green investment assets have started to cast a substantially wider net, looking at companies from a fundamentally different point of view: Is the company playing a part—even a minor one—in supporting the movement to sustainable alternatives?[2] Caught in that net is a much broader spectrum of investment possibilities, such as companies in traditionally non-green industries, like oil, where industry leaders like Suncor are developing leading edge, clean retrieval solutions; or in unrelated industries, where a company stands out as the best environmental performer, such as IBM. A company like IBM has a wide range of environmental initiatives in place, and recently completed a green data center, which is expected to use 50 percent less energy than comparable size traditional data centers that normally consume about two percent of the total energy generated in the United States.[3]

At this intersection, green investing now represents a striking combination of financial and environmental performance that may benefit the retirement and institutional investor. Many investors believe that proactively seeking greener companies has the potential to deliver better overall portfolio performance and lower risk.[4]

KEY ENVIRONMENTAL ISSUES

It is important to appreciate that most environmental issues vary across companies, sectors, and regions, although certain core issues impact nearly all companies:

- Climate change
- Water quality and scarcity
- Waste management
- Local environmental pollution

What's important for investors to appreciate is that every company manages their environmental risks—and opportunities—differently. Some companies struggle just to keep pace with environmental compliance and therefore may be at greater financial risk, whether through increased costs or the threat of heavy penalties for non-compliance. Others are aggressively managing their risks, reducing their carbon footprint (thereby presumably reducing costs), or manufacturing a product or delivering a service that addresses a key environmental issue. They therefore, could stand to financially benefit from their efforts.

It is important to note too that good environmental stewardship often goes hand-in-hand with strong positions on social and governance issues.

CLIMATE CHANGE—THE LEADING EDGE OF GREEN INVESTING

Climate change has emerged as one of the biggest areas of interest to institutional investors. In 2011, over 90 major institutional investors with nearly $10 trillion in assets under management (AUM) are embedding climate change analysis into their investment due diligence.[5]

The New York State Common Fund employs a comprehensive climate-change investment strategy to manage over $200 million internally. The fund invests in select member companies of the FTSE Environmental Technology 50 and the HSBC Global Climate Change Index.[6]

The California Teachers' Retirement System (CalSTRS) announced that they will begin systematically reviewing how each of their managers is addressing climate risk. Says Jack Ehnes, CalSTRS chief executive officer: "As a long-term investor, CalSTRS wants to invest in well-managed companies that can address the physical risks of climate change and adapt to the changing regulatory and market realities of a carbon-constrained economy."[7]

TODAY'S GREEN INVESTING—CASTING A WIDER NET

No longer limited to just excluding companies that are "part of the problem," green investments can be found across a wide spectrum of industries and companies.

- **Best green practices.** Companies—regardless of industry—who reflect best green practices, such as a commitment to recycling, reducing water use, or mitigating local pollution.
- **Thematic.** Companies that are well positioned to manage a particular environmental challenge, such as climate change.
- **Pure play.** Companies producing highly specific products to address environmental issues, such as producers of alternative energy.

SHADES OF GREEN—COMPANIES FOCUSING ON GREEN INITIATIVES

BEST GREEN PRACTICES Embodies best green practices, regardless of industry.	**SUNCOR ENERGY (TSX)** A technology leader in oil sands development. ■ Targeted investment of $750 million in renewables by 2012. ■ Implemented an environmental excellence plan in 2010 focused on improving energy efficiency, absolute reductions in fresh water consumption, air emissions, and significantly increasing land reclaimed. ■ Invested in technology, improved energy efficiency, and reduced GHG emissions intensity at oil sands base plant by 53.6 percent, compared to 1990 levels. ■ Announced a $120 million expansion of its ethanol production facility as part of the company's ongoing commitment to invest in renewable energy. ■ Worked closely with the Oil Sands Leadership Initiative (OSLI) determined to make tangible improvements to environmental, social, and economic performance in the oil sands industry.[8]
THEMATIC Well positioned to manage a particular environmental challenge, such as climate change.	**JOHNSON CONTROLS, INC. (JCI)** An industrial company that provides batteries and interiors for auto manufacturers. ■ Awarded a $300 million stimulus grant in 2009 by the Department of Energy to build a domestic lithium ion manufacturing capacity.[9] ■ Built an energy efficiency business focused on HVAC (heating, ventilation, air conditioning and controls).[10] ■ Won a contract to make the Empire State Building more efficient—reducing energy use by 40 percent, saving $4.4 million annually.[11] ■ A leader in sustainability disclosure for years and committed to sustainability reporting since 2002, reporting ESG information according to the Global Reporting Initiative guidelines since 2003.[12] ■ Represented in the 2010 S&P 500 Carbon Performance Leadership Index.[13]
PURE PLAY Companies producing products or services to address environmental issues, such as those in the alternative energy field.	**FIRST SOLAR (FSLR)** The largest manufacturer of thin film photovoltaic (PV) solar modules. ■ Lowest manufacturing cost in the solar industry, less than $1 watt, and expects to have this cost nearly cut in half by 2014. ■ Developed the first comprehensive, prefunded module collection and recycling program in the PV industry. ■ Developed energy solutions with the smallest carbon footprint and fastest energy payback time of PV technologies. ■ Created thousands of new green jobs. ■ When in operation, modules generate electricity with no air emissions, no waste production, and no water use.[14]

As of March 31, 2011, accounts managed by Calvert Investment Management, Inc. held securities issued by the following companies: Suncor Energy, Inc., Johnson Controls, Inc., IBM, and First Solar. Calvert may or may not still invest in, and is not recommending any action on, companies listed.

A CLOSER LOOK AT THE CASE FOR GREEN INVESTING

The Academic Case

Further, among environmental, social and governance issues, environmental performance emerges as one of the clearest issues tied to financial performance. For example, the particularly influential study "The Economic Value of Corporate Eco-Efficiency" revealed that companies with better environmental performance ratings during the period from 1996 to 2002 had a higher firm value (as measured by Tobin's q) and better operating performance (as measured by Return on Assets).[15]

A number of academic studies have examined the links between environmental considerations — as well as social and governance issues — and financial performance. The United Nations Environment Programme (UNEP) Finance Initiative released a report in 2007 conducted by Mercer Investment Consulting titled "Demystifying Responsible Investment Performance."[16] This report demonstrated that half of the academic studies reviewed showed a positive connection between environmental, social and governance factors and portfolio performance. A follow-up report by Mercer in 2009, "Shedding light on responsible investment: Approaches, returns and impacts,"[17] showed further evidence of this trend. Of the 36 academic studies reviewed by both reports, 22 showed a positive relationship, eight showed a neutral relationship, and only six showed evidence of a negative relationship.

The Investment Case

While an increasingly tight regulatory environment across the globe has been a major catalyst for environmental change, the private sector will be the engine that drives transformational environmental initiatives.

Companies and shareholders alike are quickly learning that an affirmative stance on the environment can lead to better long-term financial health. Being a better environmental steward reduces operating expenses, through less water, energy, and raw material consumption. Inattention to environmental risks can have meaningful consequences for energy consumption, the loss of goodwill in the communities in which a company operates, and significant expense—in the form of fines for non-compliance, legal judgments, physical damage to facilities, and insurance costs.

As the importance of good environmental stewardship becomes part of a company's DNA, they are moving from simple compliance to proactively tackling major environmental issues like climate change and water scarcity. Arguably, these companies demonstrate stronger industry leadership and an

Over time, more investors are seeking both positive environmental impact and financial performance in their investments, realizing they can go hand in hand.

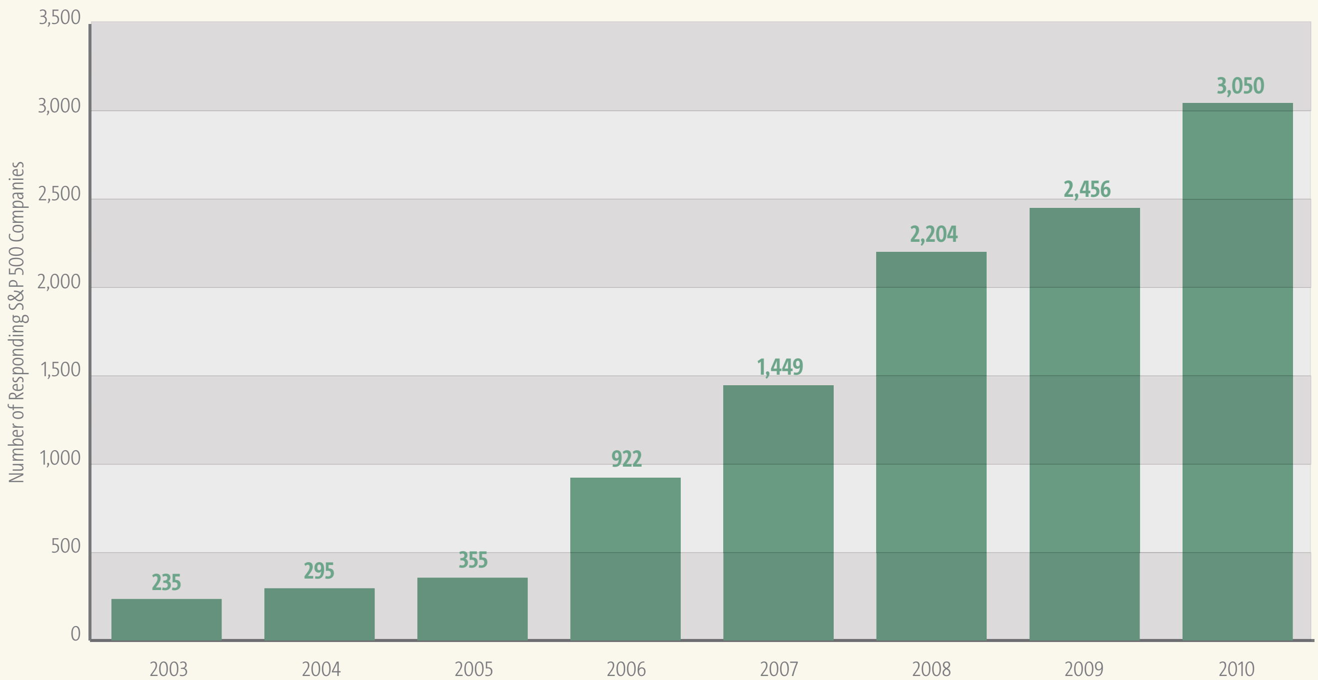
ability to more quickly adapt to risks and opportunities. That means that they may be healthier investments over the long term.

BETTER REPORTING HELPS IDENTIFY GREEN INVESTMENT OPPORTUNITIES

Supporting these pioneering institutional investors is greater availability of carbon-related data and the increasing sophistication of that data. An international initiative designed to encourage companies to voluntarily disclose carbon risk is gaining traction. The Carbon Disclosure Project (CDP), launched in 2002, now represents over 550 institutional investors with AUM of $71 trillion. The CDP surveys members of the S&P 500 and other major global indices annually to assess their response to climate risk and opportunity. Response rates are climbing; in 2010 the response rate from S&P 500 members exceeded 70 percent.[18]

CDP SURVEY RESPONSE RATE EXCEEDED 70 PERCENT FROM S&P 500 MEMBERS IN 2010

The number of disclosing companies has grown tenfold since the first request for climate change information in 2003.



Source: Carbon Disclosure Project

Recently, a group of 35 institutional investors with $7.6 trillion AUM has joined with the CDP in a new initiative to improve the management of greenhouse gas emissions by member companies.

The group, known as the CDP Carbon Action, will send action request letters to the world's largest companies, asking them to go beyond merely reporting on greenhouse gas emissions to clearly demonstrating effective emissions management.

Recipients of the action letter are being asked to set emissions reduction targets, quantify their progress toward the target, and invest in emissions reduction initiatives. The companies also have been asked to "demonstrate these actions by disclosing them, including any examples of best practice," according to CDP. Companies will report information through the CDP's information system. This burgeoning trend of improved disclosure will help investors better identify strong investment opportunities in the green sector.[19]

In addition to the above reporting initiative, mainstream investment analysts now have robust energy usage and policy data instantly available through their Bloomberg terminals. Research firms such as Trucost Plc. are also compiling carbon data from the CDP as a resource for investors. Trucost data enables investors to identify and measure environmental risks posed by a company's operations, supply chains, and investments.[20]

GREEN AND BEYOND

Green investing is gaining traction as an important new retirement plan investment option and institutional investment approach that can provide competitive risk-adjusted performance.[21]

Increasingly, investors have begun to appreciate that environmental considerations are deeply connected with other issues like energy security, global poverty, corporate integrity, consumer safety, workforce diversity, and community relations. These too can have direct bottom-line implications for companies and smart management teams are working hard to deliver strong policies and performance in these areas. In an upcoming paper we will discuss the full range of environmental, social, and governance issues and opportunities for the institutional investor.

HOW CAN INVESTORS FIND MORE INFORMATION ON GREEN INVESTMENTS?

There are a growing number of investment options that can be considered "green" across most investing styles and asset classes.

Green investment strategies are available to the institutional and retirement investor through a variety of mutual fund and separate account structures. The first step is determining which approach is right for your particular institution or plan.

For more information, please contact David W. Leach, Vice President, Institutional Strategic Partnerships, Calvert Investment Distributors, Inc.* at **240.421.1052** or review the resources below.

*Calvert Investment Distributors, Inc. was named Calvert Distributors, Inc. prior to 4/30/11

RESOURCES

Visit Calvert Investments, Inc. website: **www.calvert.com** to find the following:

Calvert White Papers

A Bright Future for Alternative Energy

Unparalleled Challenge and Opportunity in Water

Studies/Other Resources

Mercer Study/Resource Guide: "Defined Contribution Plans and Socially Responsible Investing in the United States"

SRI Studies: www.sristudies.org/Key+Studies

Social Investment Forum: www.socialinvest.org

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