ENERGY STAR

# OFF THE CHARTS

AN EPA E-NEWSLETTER COVERING ENERGY MANAGEMENT FOR THE FINANCIAL MARKETS

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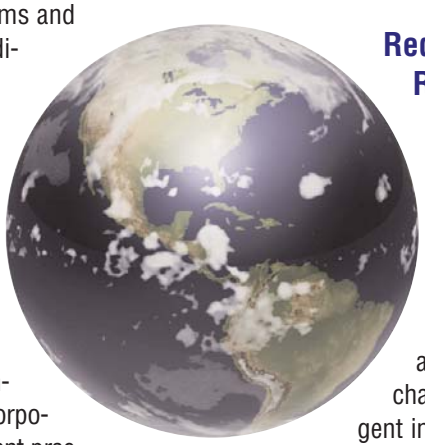
# INVESTOR DEMAND FOR CLIMATE RISK INFORMATION GROWS

Many investors who think about energy efficiency and climate change risk tend to view these topics in cost/risk terms and as constraints on traditional investment approaches. Investors should instead consider a company's climate change preparedness as an indicator of sound management, strategic orientation, and future financial success. Strong corporate energy management practices, such as those identified by the U.S. EPA's ENERGY STAR program, are critical to preparing for and managing climate risks. Setting goals to reduce greenhouse gases and demonstrating performance through voluntary initiatives like the U.S. EPA's Climate Leaders, Green Power Partnership, and ENERGY STAR programs reveals which companies are taking steps to reduce risks now.



Increasingly, investors are developing strategies to evaluate and characterize climate risks. In fact, in May 2005, a group of large institutional investors representing more than $3 trillion in assets signed an aggressive action plan outlining immediate steps to reduce risks to investments posed by climate change. Soon after, the socially responsible investment research firm KLD launched its Global Climate 100SM Index and, in September, the Carbon Disclosure Project will release its third report on corporate disclosure of climate change risks.

## Reducing Climate-Related Risks Now

To reduce exposure to climate-related risks, some investors are beginning to adjust their portfolios. "The potential business risks and opportunities associated with climate change should prompt diligent investors to better understand the policies and programs of companies they own," says Tim Smith, director of socially responsive investing at Walden Asset Management. "Hundreds of major companies are moving decisively to measure, disclose, and limit greenhouse gas emissions, in addition to looking at the business opportunities associated with climate change. This is in the interest of both companies and their shareowners."

Investors can adopt investment strategies to minimize climate risks. A first step is to assess risk exposure of a given portfolio by simply researching the climate strategies – or lack thereof – of the companies held. "We see three prime categories of risks that could negatively influence investment values," observes Matthew Kiernan, CEO of the investment advisory firm Innovest.

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We welcome your questions and comments at any time on how *Off the Charts* can better serve your informational needs. Please contact us at:

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## What's Next for Socially Responsible Investing?

We asked two leaders of the socially responsible investing (SRI) community to share their views on the industry, future issues, and climate change:

- Julie Gorte, Vice President, Chief Social Investment Strategist, at Calvert; and
- Paul Hilton, now Social Marketing Director at Calvert, after more than 10 years in the SRI practices of Smith Barney Asset Management and The Dreyfus Corporation.

### *What are the main differences between SRI and mainstream investing?*

What we are doing in socially responsible investing is very similar to mainstream investing – we look for well-managed companies capable of adding durable long-term value. But we look for our information in places where the traditional investment community typically does not. While we look at financial factors, SRI also looks at the other kinds of good management, such as how companies treat their employees and the environment. We believe that gives us at least as much insight into good management as straight financial analysis.

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## WHAT'S INSIDE:

# INVESTOR DEMAND FOR CLIMATE RISK INFORMATION GROWS

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"Namely, regulatory, weather, and litigation risks." In other words, new rules and regulations limiting industries' greenhouse gas (GHG) emissions; physical changes in weather patterns and storm severity that can affect supply chains and operating performance; and lawsuits from public or private parties that might attempt to assign some degree of financial liability to major GHG emitters.

*Framing Climate Risk in Portfolio Management,* a recent report by CERES and the World Resources Institute, takes a similar tack by recommending that investors ask themselves: "Under what circumstances might climate change affect my portfolio – and to what degree?" To address this question, the report states that investors must understand the sector-specific and company-specific risks of their holdings. Since sector-specific risks will likely affect all companies in a sector equally, characterizing company-specific risks is key for differentiating risk among companies.

For most companies, carbon dioxide associated with energy use is the largest potential GHG emission. So an important aspect of characterizing company-specific risk is gauging the quality of a firm's energy management program. Corporate energy management programs will form the foundation for efforts to reduce climate change risks from energy use for most sectors. Strong corporate energy management programs should be actively promoting energy efficiency to meet energy reduction goals and include procurement strategies that include renewables. Energy programs should have dedicated staff, formal goals, and a clearly articulated management framework. The U.S. Environmental Protection Agency's ENERGY STAR®, Climate Leaders, and Green Power Partnership programs all provide guidance and benchmarking data that articulate best practices for energy and climate change risk management. Investors can take advantage of these resources when evaluating corporate energy management practices.

A second, related step is gathering financially relevant information. Recently, investors have collectively pushed for corporate disclosure to gain access to more reliable and accurate information. The Carbon Disclosure Project (CDP) is one such example (see sidebar, "The Carbon Disclosure Project") that has gained significant momentum and is now backed by more than 155 institutional investors with assets of $22 trillion. The CDP asks the 500 largest companies in the world to disclose investment-relevant information concerning their GHG emissions to investors.

To date, two major reports have been issued documenting corporate positioning on climate change and outlining key issues for investors. A third report on the same theme will be released on September 14, 2005. Paul Simpson, project manager at CDP states, "We have seen a big increase in the number of investors requesting data on the risks and opportunities to their portfolio from climate change. In turn, nearly 70 percent of the corporations queried on climate strategies responded with information on internal greenhouse gas emissions management strategies."

Another important source of information on corporate GHG emissions and actions is the U.S. EPA's Climate Leaders program. Climate Leaders encourages companies to develop long-term comprehensive climate change strategies. Participating companies establish an aggressive 5-10 year corporate-wide greenhouse gas (GHG) emissions reduction goal and to measure

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## The Carbon Disclosure Project

Based in London and endorsed by more than 150 institutional investors representing more than $20 trillion in assets, the Carbon Disclosure Project (CDP) is non-governmental organization that seeks to improve corporate disclosure of the possible material impacts from global climate change. On September 14, 2005, the CDP released its third report on corporate responses to climate change, which presents the responses of 450 of the Global FT500 companies surveyed.

According to the CDP, 90 percent of the 2005 respondents believe that climate change will bring about threats and opportunities to current business practices. Analysis of company responses shows that many companies have made progress in both the disclosure and the strategic management of climate change risk and its associated business opportunities. Survey results also reveal that there is still room for improvement, especially in terms of achieving GHG emission reductions. Additionally, the report provides a sector-by-sector analysis of carbon intensity and highlights industry-specific risks, opportunities, and best practices to reduce risks associated with climate change.

Other highlights from the CDP's third report include:

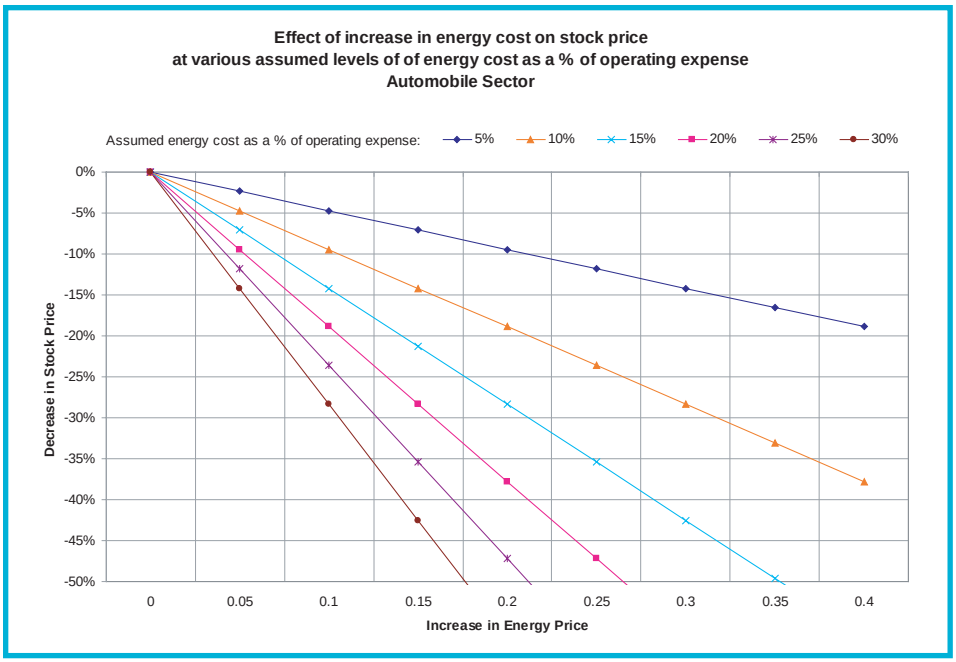
- The growth in carbon funds for investing in emission reduction credits. These funds have now reached $1.5 billion in value worldwide, and U.S.-based hedge funds are entering the 'carbon market' through equity stakes in specialized emission trading firms.
- New developments in the proper accounting methods for disclosing emission allowances. Major accounting organizations are now issuing specific guidance on accounting for carbon assets/liabilities and disclosure protocol in the Management Discussion & Analysis section of annual reports.
- The Climate Leadership Index, comprised of the 60 best-in-sector responses across 12 designated industrial sectors. This index isolates top performers on a metric weighted for climate change.

# EPA UNVEILS NEW ENERGY PERFORMANCE INDICATOR FOR AUTOMOBILE ASSEMBLY PLANTS

Miles per gallon is a convenient way to compare how efficiently motor vehicles use gasoline. Now the energy performance of assembly plants that produce motor vehicles can be compared in an equally effective manner on a scale of 1 to 100.

In June, EPA released the ENERGY STAR Automobile Assembly Plant Energy Performance Indicator (EPI), a new rating system to help the automobile industry evaluate the energy performance of its assembly plants. The rating system compares the energy efficiency of an assembly plant producing passenger cars, light-duty trucks, sport utility vehicles, or vans in the United States to that of the entire industry. The rating system is the first of its kind for manufacturing facilities and enables companies to determine how efficiently each plant is using energy within the industry, and to see that better energy performance is possible.

EPA and the automobile industry worked jointly to develop the EPI and were supported by the analytical skills of Argonne National Laboratory. Benchmarking facility energy use is a critical function in strategic energy management. The EPI is valuable because it enables companies to set aggressive energy goals and measure the improvement of their energy use. As a result, the EPI is a useful tool that can assist auto companies in mitigating the risks of rising energy costs.




*Source:* Innovest Strategic Value Advisors

## Auto Assembly Plants and Energy Use

U.S. motor vehicle manufacturers spend more than $700 million annually on energy for assembly plants. If energy use across the industry were reduced by 5 percent, the savings would be equivalent to conserving enough fuel to operate almost 78,000 average passenger cars for a year, and avoiding the emissions of more than 1 billion pounds of greenhouse gases.

Investors can use EPI scores to compare how a company is positioned to address the prospect of higher energy costs and gauge how well energy is being managed. Analysis from Innovest Strategic Value Advisors suggests that without risk management action, rising energy costs could significantly impact stock valuations in the automotive sector (see chart below). To obtain assembly plant EPI scores, investors should contact the companies directly.

Based on the input of specific plant-level information, the energy efficiency of an automobile assembly plant is scored from 1 to 100 and compared to the average and "efficient" plants in the industry. EPA defines an efficient plant at a score of 75 or better. Now, corporate energy directors can establish meaningful goals for reducing energy use in assembly plants and better managing their companies' energy costs.

More information on the EPI and EPA's ENERGY STAR Motor Vehicle Manufacturing Focus is available on the ENERGY STAR Web site at: **http://www.energystar.gov/index.cfm?c=in_focus.bus_motorveh_manuf_focus**

# What's Next for Socially Responsible Investing? *(Continued from page 1)*

### *What big changes and trends do you foresee in the SRI community in the next six to 12 months?*

While it is always hard to predict, we think we will continue to see an evolution towards the following three things:

1. Increased disclosure and transparency.
2. Growth in the spectrum of SRI asset allocation bringing investors more choices.
3. Continued growth in the socially responsible investing marketplace.

Also, we will continue to see more concerted campaign-style investor advocacy where investors work together—often with other stakeholder groups—to advance an issue. For example, in 2004, investors effectively rallied together to put pressure on big companies over the issue of corporate political contributions.

We will also see more people accepting the fact that social research can be used to identify risk—that this research can often give an early heads-up on problems that the mainstream financial community misses.

### *What has been the SRI community's most notable achievement in the past five years? What goals has the community set for the next five?*

Since 2000, the SRI community has made real progress on the following issues:

- Disclosure of proxy voting – This is a tremendous achievement that we can all be proud of. People now realize that proxies are the assets of the shareholder. The SRI community brought a united force for proxy voting disclosure—and succeeded.
- Consistency of supporting governance reforms – A recent study by the Social Investment Forum showed that SRI funds have been more consistent supporters of company governance reforms, through their proxy votes, than mainstream funds.
- Increased awareness of issues – The SRI community brought a whole range of social and environmental issues to the attention of major corporations so that they are now taking seriously things that they didn't pay any attention to in the past.

During the next five years I think we will see:

- More widespread acceptance of corporate citizenship issues. Big companies get it; mid-size and small companies are next.
- Progress on some key social issues like climate change and glass ceilings/board diversity.

### *Is there consensus forming around the criteria used to guide socially responsible investments?*

No. There is not a consensus forming, nor should there be. There are always a number of approaches to investing. Competition drives progress. There are many approaches to social and environmental issues, so it stands to reason that there can be many thoughtful approaches to social investing. It all comes down to the fact that people should have choices on where to invest their money, and competition in the industry leads to more choices.

### *Is climate change permanently on the SRI radar screen? Where does it rank among the issues of concern to the SRI community?*

Climate change is on the radar screen. It is one of the top three leading SRI issues. Most SRI funds look at it and have been looking at it for years and years. In addition, CERES was spectacularly successful in making climate change a governance issue. Even if a company doesn't believe climate change is happening, they now can't ignore it. After Kyoto, emissions now have a cost and reductions have a value—global companies now have to pay attention to these issues.

### *How are companies managing risks associated with climate change?*

There are three ways that companies are thinking about climate change. For companies with large amounts of emissions, it is becoming part of their portfolio. They are taking on quantitative, timed schedules for reductions of emissions. For companies with smaller levels of emissions, they are looking at other ways to reduce and manage their carbon signature. One tool for this is the Carbon Disclosure Project that gives companies a way in which they can count and report their emissions to investors. And other companies are trying to turn climate change into an opportunity by finding ways to make money on it. This is driving a lot more investment in alternative technologies, like wind and solar.

### *Do any SRI firms use corporate energy management as an indicator of social responsibility? If so, how is corporate energy management measured?*

All companies should strategically manage their energy use because it is a cost. This is more critical, of course, for more energy-intensive businesses, but it can be an important indicator of management attentiveness to costs in any company. SRI firms definitely use it as a screen for energy-intensive companies. For less energy-intensive companies, it is not usually used as a yes/no screen. For these companies, it is hard to tell if a company is practicing good energy management. You have to depend on self-reporting or third-party sources and audits. A few of the many sources we use are Blue Angel, ENERGY STAR®, WRI, and ACEEE. When carbon becomes regulated in the U.S. (and we believe it will become regulated), energy management will become easier to measure.

### *Has Sarbanes-Oxley led companies to be more transparent about reporting risks related to climate change?*

Yes, it has helped push forth the trend toward transparency that was already

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# INVESTOR DEMAND FOR CLIMATE RISK INFORMATION GROWS *(Continued from page 2)*

annual progress towards their goal. By doing so, companies create a lasting record of their accomplishments and position themselves to better manage GHG emissions and their associated risks as climate change policy continues to unfold.

Brokerage houses are also starting to realize that comprehensive and sophisticated management of climate risks is a critical risk skill for companies operating in carbon-constrained regions. For example, during the past two years, Citigroup, CSFB, Goldman Sachs, HSBC, ABN Amro, and UBS have produced investment research reports on climate change.

The final step is acting on this information. "Many analysts are already considering climate change risk management as key factor in their overall analysis of company performance," says Paul Hilton, Social Marketing Director at Calvert. "This is a trend that will grow exponentially over the next decade. Companies that establish themselves as early leaders will no doubt benefit from increased analyst attention and ultimately enhanced valuations."

## It's Not Just About Risk: The Upside Opportunities

As with any change in market conditions, the risk of climate change will open up new opportunities for growth and profit. For example, power generation facilities, low- emissions enterprises in the transportation sector, and businesses producing products or technologies that reduce emissions from industrial processes are poised for future growth. In addition, energy efficiency technologies also appear to be poised for growth as pressure mounts to make buildings and industrial facilities more energy efficient in light of increasing energy prices and the climate risks associated with energy use and production.

In hot pursuit of these future profits is GE. In May, GE announced that by 2010 it would be investing $1.5 billion a year in energy efficient and environmental technologies to capture $20 billion in revenue from these products and services. A core part of this initiative centers on technologies that reduce GHG emissions. GE has also joined the EPA's Climate Leaders program.

## Are Investors Leaving Money on the Table?

By not taking climate change factors into explicit account, money managers are, in effect, leaving money on the table, and across a wide variety of asset classes: domestic equities, international equities, corporate bonds, and real estate, for starters. Since reducing GHG emissions associated with energy use reduces energy costs, investors concerned with the operational efficiency of their holdings should take note. As this realization sinks in with both the owners of assets and those who manage them (as it has in Europe), expect a whole new suite of investment products and approaches to emerge—and jump on them.

## EPA Resources

- ENERGY STAR Guidelines for Energy Management – **www.energystar.gov/index.cfm?c=guidelines.guidelines_index/**
- U.S. EPA Climate Leaders program – **www.epa.gov/climateleaders/**
- U.S. EPA Green Power Partnership – **www.epa.gov/greenpower**

## Other Resources

- Investor Network on Climate Risk Action Plan – **www.incr.com**
- Framing Climate Risk in Portfolio Management report – **http://climate.wri.org/portfoliomanagement-pub-4028.html**
- Carbon Disclosure Project – **www.cdproject.net**

# What's Next for Socially Responsible Investing?

*(Continued from page 4)*

emerging. Information is the currency of every market everywhere in the world. Transparency leads to more information and therefore makes the market efficient. The trend towards greater transparency will continue.

### *What key strategies can the SRI community use to build the confidence of investors?*

The SRI community needs to continue to prove the link between CSR performance and financial performance. We need to show how social research is being used effectively as an extra lens to identify risk. We need to use this information to show investors that we have broken the myth that you have to give up returns to do socially responsible investing.

### *Your thoughts?*

*Off the Charts* welcomes your thoughts on SRI, climate change, and what the next decade may bring. E-mail your comments to buildings@energystar.gov.