

Institutional ESG Investing Program

1Q10

ESG Investment Update

On the Environmental, Social and Governance (ESG) Investing front, we would like to discuss several recent announcements from two federal agencies – the Environmental Protection Agency (EPA) and the Securities and Exchange Commission (SEC) – on the issue of climate change that we think are significant.

In December 2009 the EPA promulgated the “endangerment finding” which, when in effect, will give the administration the authority to regulate greenhouse gases under the Clean Air Act.¹ This finding builds on the Supreme Court ruling in April 2007² that greenhouse gases are air pollutants covered by the Clean Air Act, as well as the proposed findings by the EPA in April 2009 that six greenhouse gases contribute to air pollution that endanger public health and the environment. The endangerment finding’s scope is limited to *new* motor vehicles (approximately 25% of the transportation sector emissions comes from cars and trucks)³ but the expected gains, estimated at \$240 billion in monetized benefits, should still be significant and outweigh the expected costs at \$52 billion. In addition, over the lifetime of the vehicles sold during 2012-2016 under this program, projected greenhouse gas emissions will be reduced by 960 million metric tons and 1.8 billion barrels of oil will be saved.⁴

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Along these lines, in October 2009, the EPA set a final ruling on which industries will now be required to calculate and report on their greenhouse gas emissions. Included are fossil fuel suppliers and industrial gas suppliers, direct greenhouse gas emitters and manufacturers of heavy-duty and off-road vehicles and engines.⁵

On January 27, 2010, the SEC issued interpretive guidance on existing disclosure requirements as applied to business or legal developments on climate

¹ www.epa.gov/climatechange/endangerment.html

² *Massachusetts v. EPA*, 549 U.S. 497 (2007)

³ U.S. Department of Energy (DOE), *Transportation Energy Data Book*, Table 2.6, 2008.

⁴ EPA, Office of Transportation and Air Quality, *Regulatory Announcement*, EPA-420-F-10-014, April 2010.

⁵ 74 Fed. Reg. 56,260 (October 30, 2009).

change.⁶ The document focuses on four areas of climate change that may warrant disclosure: impacts of existing and pending laws and regulations relating to climate change; impacts of foreign and international treaties and accords relating to climate change; indirect impacts of legal, technological, political and scientific developments regarding climate change; and the physical impacts of climate change. One sell-side research shop noted that carbon intensity, the amount of carbon by weight emitted per unit of energy consumed, is a significant factor responsible for stock valuation differences in certain U.S. industries such as airlines, mining and utilities.⁷

Investors have been requesting for some time now that companies disclose material climate-related risks in their reporting to the public, and according to Ceres,⁸ this guidance is the first economy-wide climate risk disclosure in the world. Further, in March 2010, over 50 institutional investors, representing \$2.1 trillion in assets, including many of the largest state pension funds, sent a letter to SEC Chairwoman Mary Shapiro, re-affirming their support of the SEC interpretive guidance to publicly traded companies on climate-change related disclosure.⁹

ClearBridge has been an early advocate of such disclosure requirements in our support of the Carbon Disclosure Project (CDP),¹⁰ the Global Reporting Initiative,¹¹ and other ESG-related reporting. Our sector analysts will continue to follow the potential impact of these EPA and SEC pronouncements, and we will continue to raise climate risk issues with the companies in our ESG portfolios. Our ESG Investing approach will also continue to include active company engagement on reporting and transparency issues.

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⁶ www.sec.gov/news/press/2010/2010-15.htm

⁷ Goldman Sachs Sustain, May 21, 2009.

⁸ Ceres is a non-profit and national network of investors, environmental organizations and other public interest groups.

⁹ www.ceres.org

¹⁰ The CDP is an independent, not-for-profit housing the largest global database of primary corporate climate change information.

¹¹ www.globalreporting.org