

October 2020

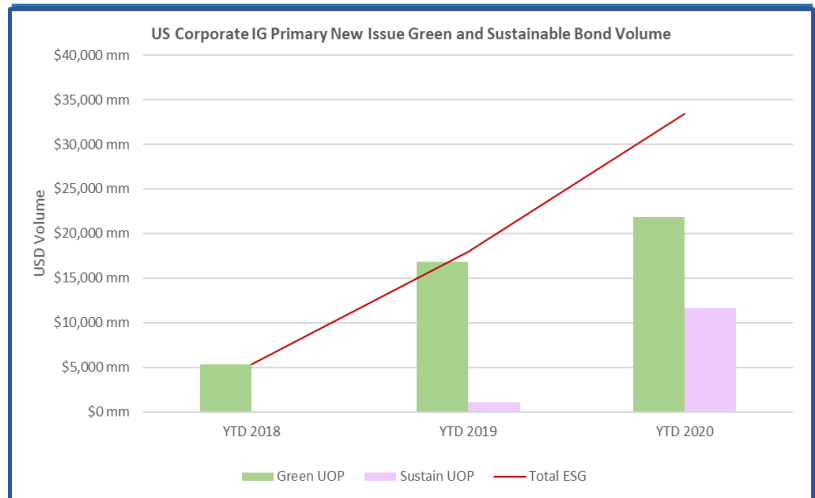
These past few months have seen several developments involving sustainability and demand for sustainability/ESG themed investments, including a variety of funds (and a number of new Sustainable/ESG themed Special Purpose Acquisition Companies). Despite the recent news headlines and filings, it was the low-key announcement of a water futures contract that caught our attention.

Recently, the CME Group announced its plan to launch its first ever water futures contract, the NQH2O index—which tracks the spot price of water in California. The futures are quite relevant, as their announcement comes on the heels of a recent report from SEC Commissioner Rostin Behnam entitled “Managing Climate Risk in The U.S. Financial System” which recommended that the CFTC coordinate with other regulators in supporting the development of a “robust ecosystem of climate-related risk management products.”

Water stress is a growing concern to communities and businesses around the world, as current climate change scenarios anticipate half the world’s population to be living under water-stressed conditions by 2030. Simultaneously, here in the US, communities continue battling fires related to water stress and drought, as almost 35% of U.S. states rank below average for precipitation in 2020, and over 32% of the contiguous U.S. is in moderate or extreme drought. The economic impact of water scarcity should not be underestimated. A voluntary study performed by nine major international banks (with combined assets of over \$10 trillion) found that extreme droughts would increase loan default losses 10-fold for certain portfolios, with the most affected sectors being water supply, agriculture, and for certain countries, power generation.

While not an ESG investment in their own right, water futures could be the beginning of forward-looking pricing as it relates to hydro-planning and dealing with water scarcity—thus having a positive tertiary effect on Sustainability/ESG. Market participants, especially those involved in agriculture, will be able to more accurately hedge and price the cost of water needed for irrigation, as well as other large withdrawers including manufacturing, which can use the futures to navigate fluctuating prices or for efficiency planning. For example, if water futures continue to rise, an issuer’s treasury and sustainability teams can begin to model and plan proper investments into water efficiency controls & technology, helping to reduce water withdrawal and enhance overall ESG scores.

We expect that if approved, CME’s water futures contract will not be the last, but likely the beginning of more to come. Other areas of the U.S. and the world, that are rich in agricultural production and capacity like the mid-west, represent further opportunities for water futures. It does not stop there either...given the global challenges associated with adapting to climate change, there is substantially more room for climate-related risk management products that extend beyond water.



debt issuance remains strong with multiple issuers from across sectors, including Verizon, JP Morgan, Johnson Controls, Arizona Public Service, Host Hotels & Resorts, and Equinix coming to market this fall with green bonds. In September, Bank of America issued a \$2bln sustainability/equality progress bond with UOP dedicated to advancing racial equality, economic opportunity, and environmental sustainability. This month, both Citi and Morgan Stanley issued social bonds, allocating funds raised in accordance with their frameworks toward affordable housing to low (or moderate) income individuals & families.

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Further Resources

- **SEC Report:** <https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf>
- **UN Water Facts:** <https://www.un.org/waterforlifedecade/scarcity.shtml#:~:text=Around%20700%20million%20people%20in,living%20under%20water%20stressed%20conditions.>
- **CME Press Release :** https://www.cmegroup.com/media-room/press-releases/2020/9/17/cme_group_to_launchfirst-everwaterfuturesbasedonnasdaqvelescalif.html
- **NASDAQ Press Release:** <https://www.nasdaq.com/solutions/nasdaq-veles-water-index>
- **US Drought Conditions;** <https://www.drought.gov/drought/data-maps-tools/current-conditions>
- **NOAA Precipitation Maps:** [https://www.ncdc.noaa.gov/temp-and-precip/us-maps/ytd/201008?products\[\]=statewidepcpnrank#us-maps-select](https://www.ncdc.noaa.gov/temp-and-precip/us-maps/ytd/201008?products[]=statewidepcpnrank#us-maps-select)

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