COVID-19 Global Pandemic

ESG & SRI Newsletter ***May 18, 2020***

SHENKMAN

Introduction

The global COVID-19 pandemic that has dominated financial markets since late February is also impacting assessments of ESG and SRI factors. Specifically, it is shifting where some ESG risks for investors lie, and will require increased analytical monitoring. We believe there may be intense focus on social issues, particularly on how companies interact with employees, customers and other stakeholders. Our firm also expects that recent, dramatic declines in pollution levels and energy prices could reprioritize certain environmental issues.

Changes on Social Scrutiny

As nations focus on a common concern, corporate behaviors have come under more scrutiny. This crisis is far different than those management teams have dealt with in the past; whereas some businesses have been ordered to shut their facilities, others deemed to be essential are expected to continue operating. Still others have been asked, or ordered, to repurpose some production for the national well-being. This situation has heightened certain ESG risks, and will require increased evaluation of ESG factors. Analysis must increasingly focus on how companies interact with stakeholders such as employees, customers, communities and suppliers. For instance, companies are adjusting their processes and investing in work environments to enhance employees' safety. For example, Amazon's shareholder letter said that they "…made over 150 significant process changes…" and now provide masks and gloves to employees, and include six hours of safety training for new hires. These new requirements for employee and customer safety add to the cost of doing business, both in cash and potentially reduced efficiencies. However, the dangers of not enacting these new measures are great, and could create significant employee, customer, and potentially government backlash, as well as the threat of civil actions. As always, there is a risk that this sentiment could go too far and that companies may be pressured to follow unnecessary protocols that might not particularly apply to their businesses (i.e., "COVID-washing").

Other factors may result in social issues, or possibly praise, including implications arising from taking government funds from new emergency programs. Most notably, perhaps they may include how corporations handle the rehiring of employees that have been part of layoffs or furloughs. U.S. unemployment skyrocketed to 14.7% in April, and many of the government loan programs have explicit conditions about what companies must do about employee payments and job retention. We believe it is likely that as lockdowns ease, companies that permanently release, or do not rehire, employees could face significant public scrutiny, as well as legal risk from an increasingly "employee-friendly" legislative environment. This may even be the case with businesses or industries that face considerable economic challenges. How companies handle employee headcount could of course be a larger issue for those that have accepted any form of government funds, as these businesses will likely be under the microscope for longer than the time they have any government loans outstanding. Finally, it is worth noting that some companies have come under public criticism for taking government funding that was viewed to be intended for smaller businesses.

Changes in Environmental Considerations

The coronavirus pandemic may also refocus risks related to environmental issues. First, a number of articles have discussed whether differences in air quality conditions amongst various regions have impacted the level of virus penetration. There is likely to be an increasing number of scientific studies on the topic, which could increase pressure on companies that negatively impact air quality. Secondly, reports of dramatic improvements in air quality in many areas have been attributed to decreased manufacturing and auto traffic, which could accelerate green investments, and intensify pressure for public transportation enhancements, potential tariffs on drivers in urban areas and possibly programs to encourage telecommuting. However, this may be counterbalanced by concerns over social distancing on public transportation. Government policies on public transport could shift as well, perhaps with efforts to add bike lanes, which are more accommodative to distancing. Finally, marked declines in oil prices could impact the near-term economic benefits of alternative energy sources. With many companies and individuals facing increased economic pressures, spending more on cleaner energy sources that require higher upfront and ongoing costs will become a harder choice, even though avoidance could hurt a company competitively over the longer term.

Closing Remarks

The global pandemic has increased risks in all aspects of investing and is likely to alter many ESG dynamics. Focus on certain socially responsible investing issues could shift, as awareness of social issues should remain elevated. Adequately assessing these risks requires increased analysis of credit risk, greater interaction with company management teams, and comparisons of best practices within industries and across sectors.

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