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Post-Election ESG Policy Outlook

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ESG factors are a vital aspect of investment analysis and can influence how debt securities can trade. The potential impact of ESG issues appears likely to increase quickly in the U.S. While changes in public sentiment and the use of social media can increase the degree by which security prices are affected by ESG issues, aggressive changes in government policies can lead to a more dramatic and rapid impact.

The new Administration in the U.S., with a supportive Congress, has shown that it is willing to take very swift action in many ESG areas. Actions that the Administration has undertaken, or have outlined in their plans, include changes to environmental rules related to fossil fuels and reengagement with international climate agreements. There has also been a focus on social issues in the Administration, including private prisons, consumers' rights, and labor issues. The Administration also indicated it would review ESG investing guidelines. It is our view that investors ignore these developments at their own peril. We believe that the investment firms best positioned to respond to these shifts in policy and their positive and negative impacts on investments are those that have a systematized approach to ESG and that have SRI considerations imbedded into their research and decision-making process.

Environmental Topics

Some of the major environmental issues being undertaken by the new Administration include:

- President Biden signed an executive order to rejoin the Paris Climate Agreement of 2016. The accord is focused on reducing greenhouse gas emissions.

- President Biden signed an executive order regarding the hosting of a Leaders' Climate Summit on Earth Day, April 22, 2021. This order states that the United States will "reconvene" with a commitment to elevating climate in U.S. foreign policy and will create a new position, the Special Presidential Envoy for Climate.

- President Biden signed an executive order to cancel the controversial Keystone XL pipeline, and there has been press speculation about trying to do the same for the Dakota Access pipeline.

- The Administration also put a temporary pause on the permitting and leasing of Federal lands. In the short-term, this action will likely have the most direct impact on the leveraged debt markets. Some of the key points are:

  - Federal lands permitting pause – the Interior Department imposed a 60-day moratorium on new oil and gas and minerals leases and drilling permits on Federal lands and waters.
    - **Areas impacted** – Federal lands include the entire Gulf of Mexico (GOM). Additionally, approximately 14% of active land rigs are on Federal land, 73% of which reside in the New Mexico portion of the Permian basin. New Mexico is estimated to get a substantial portion of its tax revenue from the industry, and it could ask for an exemption from this rule.
    - **Activity impacted** – the short-term impact on the industry is limited, as companies typically have one-to-two years of permits in hand.

  - Federal lands leasing pause – on January 27th, the Biden Administration issued an executive order suspending new leasing on Federal lands indefinitely, until a comprehensive review of oil and gas permitting and leasing is conducted.
    - This would prevent the purchase of new leases on Federal land and is a longer lead time impact than permitting.

  - Despite some downward pricing pressure initially around this news, we believe the Federal lands permitting / leasing suspensions will have little impact to activity or production in the near term. The larger implication is the Administration's focus on putting pressure on the industry and the potential to raise incremental costs and create uncertainty that could impact the industry's cost of capital.

Social Topics

There have also been several initiatives and announcements of review on social issues. These include:

- The private prison industry has several issuers in the leveraged finance market. Recently the Biden Administration said it will order the Department of Justice not to renew private prison contracts in the future. We wrote about concerns for the sector last year when financial institutions in New York received political pressure and some announced plans to limit funding to the industry. Federal business is only part of the revenue for most private prison companies as much of the business comes from states and municipalities. To our knowledge, there has not been any recent state or municipal actions impacting the industry. Many local and state justice systems are much more dependent on private prisons than the Federal government. However, another risk for the industry is if the Federal government threatens to withhold funding from states and municipalities if they use private service providers.

- Policy statements from the Biden campaign and the White House discuss several areas that could impact labor costs. These efforts include adopting a national $15 per hour minimum wage and potentially expanding employment-based immigration visas and guest worker programs. Additionally, the Administration has made statements that it hopes to increase opportunities for worker organization.

- The Administration has also stated it intends to undertake enhanced enforcement of workplace discrimination laws. This could increase penalties for corporations that do not have a good control environment or have been bad actors in this arena. Monitoring, as best as one can, how the control environment and how well management teams address employee, customer, and community relations is a critical part of ESG risk assessment.

- Other statements imply that the Administration expects to empower and increase the role of the Consumer Financial Protection Bureau (CFPB). Initial statements have emphasized penalizing financial institutions that have failed to provide required relief during the pandemic. Longer-term press reports imply a focus on payday lenders and language in mortgage lending agreements as likely areas of scrutiny.

ESG Investing for ERISA Plans

The Administration also cited that it would review the recent Department of Labor (DOL) ruling regarding ESG investing for pensions and ERISA related management. The DOL rule (see Shenkman Capital ESG & SRI Newsletter: August 14, 2020), which was adopted in 2020, amends the regulation of Federal retirement law and requires plan fiduciaries to select investments and strategies based solely on how they will affect the plan's financial performance, or so-called pecuniary goals. This rule implies that managers of retirees' benefits must show that investing in funds labelled ESG or SRI must be rationalized on a financial basis.

Corporate Announcements

In other recent ESG news, somewhat coincident with the new Administration, there were three notable corporate climate change pledges:

General Motors pledged to be carbon neutral by 2040 — removing emissions from all its products and global operations or offsetting those emissions through carbon credits or carbon capture within the next two decades. The company also committed to have a fully electric fleet of vehicles by 2035.

The Keystone oil pipeline's developer, TC Energy Corp., planned to announce a series of overhauls—including a pledge to use only renewable energy. They also are pledging to hire a union workforce and eliminate all greenhouse-gas emissions from operations by 2030.

Exxon Mobil rolled out a new five-year plan to reduce greenhouse gas emissions which it said was in line with the Paris Agreement. The plan includes reduction in emissions from methane flaring and upstream operations.

Closing Comment

All these recent related announcements appear to be leading to a period of increased focus on ESG policies and their impact on investment valuations. It is worth noting that the effect of policies undertaken by executive order can clearly be more fleeting than legislative actions. However, we believe the long-term trend will continue seeing ESG considerations having greater influence on investment valuations, both on a positive and negative basis. These developments increase the necessity to have an inclusive ESG investment process and one that also encompasses developing trends in SRI.

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