October 2020 / Responsible Investing

The U.S. election and America's ESG journey

How sub-national actors have taken center stage in climate action

Summary

More than a quarter of Americans questioned in a CBS News poll last year[1] considered climate change a "crisis", with a further 36% defining it as a "serious problem". Another poll carried out this year[2] revealed that almost two-thirds of Americans support policies prioritizing the environment and climate change, a record high. However, climate change ranked 13 out of 18 issues most important to voters in the election[3].

Yet, when it comes to addressing the climate emergency and the broader ESG agenda in the United States, significantly different assessments and pathways are being taken by the Republican and Democratic parties.

On the one hand, the Democrats are espousing an ambitious green agenda while on the other President Trump has been scaling back or revoking many aspects of Obama's environmental agenda. These include the decision to leave the Paris climate agreement in June 2017, repealing the Clean Power Plan in October 2017 and diminishing the role of the Environmental Protection Agency, where criminal enforcement is now at a 30 year low[4].

From a broader Environmental, Social and Governance (ESG) perspective, in April 2018 the Department of Labor pared down the role of ESG considerations in fiduciary investing that had been initially outlined in a 2015 ERISA ruling[5]. The original phrasing was that ESG issues were "proper components of the fiduciary's analysis of the economic and financial merits of competing investment choices". However, this was subsequently changed to "plan fiduciaries are not permitted to sacrifice investment return or take on additional investment risk as a means of using plan investments to promote collateral social policy goals."

In June 2020, the Department of Labor has reinforced this view that ESG may conflict with fiduciary duty[6]. The SEC's decision to amend shareholder rights will also raise additional hurdles for investors to raise ESG issues with companies[7].

Yet, whoever wins this year's Presidential election will still face the economic and financial impacts of extreme weather events. According to the National Oceanic and Atmospheric Administration (NOAA), between 1980 and 2019, 263 weather and climate disasters have hit the United States with a cumulative loss of US$1.77 trillion[8]. In comparison, financial losses in the EU-28 caused by weather and climate-related extremes between 1980 and 2017 (latest data) was estimated at approximately US$480 billion[9].

Looking into the future, the total annual price tag for hurricane and other coastal storms on US property and infrastructure is expected to reach USD 35 billion, and by 2050 up to USD 106 billion worth of existing US coastal property will likely be under sea level nationwide[10], with some homes and commercial property with 30-year mortgages literally under water before maturity.

Extreme heat is also expected to become more pervasive with the average American experiencing up to 50 days of over 35°C each year by 2050, or three times the number of extreme heat days witnessed over the past 30 years[10]. This may lead to an increased incidence of death through heat-related mortality and worsening air quality. In addition, rising temperatures may reduce labor productivity, impact agricultural yields and place significant strains on energy systems across the country.

Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect.

For Institutional investors and Professional investors

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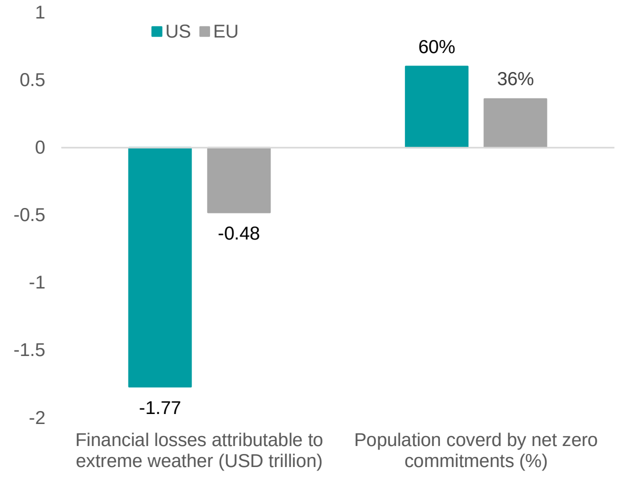
FIGURE 1. US AND EU CLIMATE LOSSES AND NET ZERO COMMITMENTS COMPARED



Source: NOAA National Center for Environmental Information (July 2020). Billion-dollar weather and climate disasters: overview (data 1980-2019); European Environment Agency (April 2019). Economic losses from climate-related extremes in Europe (data 1980-2017); New Climate Institute (September 2020). Accelerating Net Zero

In addition, the next occupant of the White House will either be working with or be challenged by a growing array of non-federal actors driving the climate and broader ESG agenda. One such example is the "We Are Still In" declaration which is a coalition of cities, states, businesses, universities and faith groups strongly opposed to the US withdrawal from the Paris climate agreement. As of December 2019, this coalition represents 65% of the US population, 68% of US GDP and 51% of the country's greenhouse gas emissions[11].

Not surprisingly, many of these non-federal actors such as states and cities are themselves pledging commitments to bring greenhouse gas emissions to net zero. In fact, such net zero commitments cover 220 million people and represent 60% of the population. In Europe, the similar commitments by subnational entities at a regional and city level basis capture just 36% of the population[12].

We expect the re-election of President Trump should maintain the status quo with little to suggest the administration would seek to promote the transition to a low carbon economy. Rather the administration is likely to safeguard against any legislation that would discriminate against the fossil fuel industry and so preserve the US's status as the world's largest producer of oil and natural gas. Indeed at the start of this year, the President has stated his intention to relax environmental law to facilitate infrastructure building in areas such as roads and pipelines[13].

In contrast, the approach of the Democratic Party is strongly supportive of climate legislation that addresses environmental risk and prevents the departure of the US from the Paris climate agreement. This may provide a more supportive environment for the green economy than exists currently. After China and Brazil, the US has the largest number of people employed in the renewables sector at 855K, with biofuels and solar accounting for almost two thirds of renewable sector employment. In comparison, the US coal industry employs around 75K jobs, with 603K and 271K in the US oil and natural gas sectors respectively[14].

The Green New Deal, which is at the heart of Presidential candidate Biden's agenda, proposes an aggressive climate and infrastructure spending plan. It would put US$2.0 trillion of spending towards clean energy with the aim of bringing US greenhouse gas emissions to net zero by 2050. Under Biden's climate plan, tax breaks would end for the fossil fuel industry with the possibility that energy companies face higher penalties and taxes. Biden has also promised to stop issuing permits for new oil and gas drilling on federal lands and waters, which represented 24% and 13% of total US oil and gas production[15] in 2017.

A Democratic sweep across the executive and legislative branches would foster the reintroduction of much if not all of the Obama environmental legislation and an immediate decree to re-join the Paris Climate Agreement. Such a strong green fiscal and regulatory agenda would therefore likely see significant investment risks and opportunities emerge across US equity markets. This legislative change would provide the most obvious tailwinds to ESG-focus investments. Sectors likely to benefit include renewables, building materials, energy efficiency technologies and e-mobility technologies in the transportation sector. Defensive and secular growth stocks would also be positioned well to withstand these significant changes.

Risks to a Democratic sweep would include US domestic earnings—which would likely experience hikes on corporate tax rates—and US banks in what is likely to become a stricter regulatory environment. Meanwhile, we would expect traditional energy and fossil fuel companies to be exposed to a more aggressive legislative programme of decarbonisation.

A clear choice therefore exists between the Republican and Democratic parties when it comes to their position and proposals in addressing the climate emergency and the ESG agenda more broadly. On the one hand, the Democrats are placing carbon neutrality at the heart of their campaign agenda compared to a Republican administration that limits any policies that could threaten the threaten the competitiveness of more traditional carbon heavy parts of the US economy and specifically the fossil fuel sector.

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