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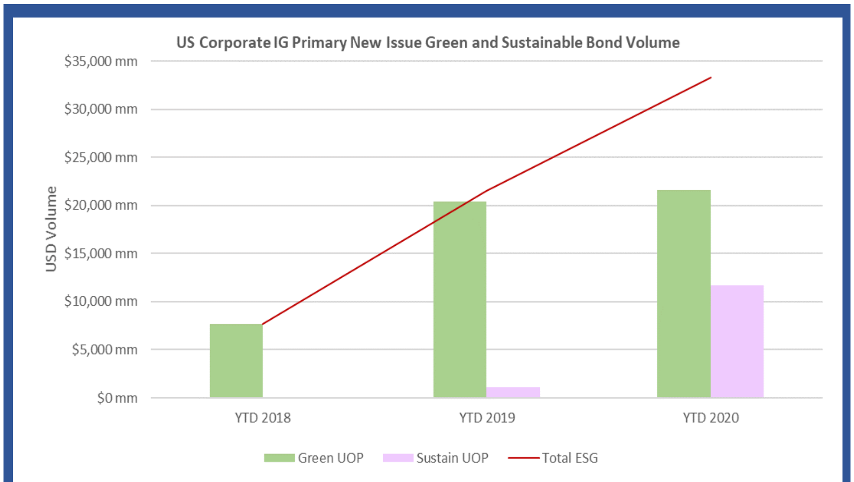
With the U.S. elections over and 2020 coming to a close, now marks an optimal time to reflect on what to expect with a new incoming President and what it might mean for markets and ESG/Sustainability. It should also come as no surprise that, as the incoming Biden administration looks to replace Trump era appointees with those in support of their policies, we will also likely see a number of government agencies and regulators more receptive to engaging on market issues related to sustainability and ESG.




Reflective of the broader market and reticence of issuers to print in-light of November's U.S. elections, ESG related issuance has decelerated in recent weeks. No major IG corporate issuers have come to market with new green or sustainable themed debt offerings, bringing YTD volume for U.S. IG green bond issuance in line with last year. Still overall ESG themed issuance remains above 2019 levels, buoyed by borrowers such as Alphabet, Pfizer, and Sysco's sustainability bond offerings, as well as Morgan Stanley, Citi, and Bank of America's social bond transactions.

## ESG & Regulators

While names have been floated in the media, the overall tone towards ESG by monetary officials and regulators under Biden will likely be more receptive than in the past and there may be further guidance on what qualifies as "Green", "Sustainable", or "ESG" investments. Earlier this year Sarah Raskin, the former U.S. Deputy Secretary of Treasury, former member of the Federal Reserve Board of Governors, and a preferred progressive candidate for the role of Biden's Treasury Secretary, spoke to the media about why U.S. regulators must address climate change. She highlighted the investor need for appropriate information necessary to allocate capital and mitigate risks. Other regulators like SEC Commissioner Allison Herren Lee have also recently called for further standardized disclosure including incorporating Scope 3 emissions into reporting, fund labelling, and establishing an ESG governing approach by asset managers. In addition, they are seeking more transparency around credit ratings agencies' incorporation of ESG, and the intersection of accounting and carbon disclosure.

It is important to note that any decision by the SEC as it relates to credit ratings, fund labelling, and ESG investment policies would be significant. However, the inclusion of Scope 3 emissions into financial reporting and investment decisions proposed by Commissioner Lee might be the most impactful to fund managers and those looking for ESG trade opportunities. Scope 1 & 2 emissions are the primary data points used to report on direct and indirect GhG emissions from operations owned by a particular entity. Scope 3 emissions are from sources not directly controlled or operated by an entity and they are much harder to calculate and there is less agreement on methodology. Inclusion of Scope 3 emissions into ESG criteria and reporting would require an extensive readjustment of ESG funds which invest based on climate concerns. Investors that have bought into positions with traditionally low Scope 1 & 2 emissions (but have large Scope 3 emissions) might need to sell out of those holdings. Common examples used include financials and banks, which do not have high Scope 1 & 2 emissions from operations, but through financing activities of certain industries, are high Scope 3 emitters.

While the discussion regarding inclusion of Scope 3 emissions is an important one, it is probably not on the immediate horizon for the SEC. A more likely area where it will pursue regulation is "ESG" related labelling. ESG/Sustainable marketed funds have attracted significant fund flows this year (+$30bln in 2020), and with hundreds of different ESG-labelled open ended funds and ETFs available, there is some confusion as to what is being marketed. We discussed this earlier in the year in our July ESG write-up when we covered SEC Commissioner Elad Roisman's speech and the DOL's earlier ESG ERISA proposal (language which has since been shelved), but given that Commissioner Lee also echoed this concern surrounding fund labels, this foreshadows possible action by the SEC under Biden.

## ESG & Central Banks

Another trend that we should expect is further Central Bank involvement on issues of Sustainability/ESG. Currently in Europe, Christine LaGarde and the ECB have already signaled their amenability to considering and engaging on climate change as a systemic financial risk and are looking at more ways to mitigate it. For instance, earlier this year Europe released its green instrument taxonomy, and in late Q3 the ECB announced its intent to begin purchasing sustainability linked bonds as collateral starting January 2021.

Here in the United States, the conversation has been less robust, but that is changing. This month, the Federal Reserve Bank released its 2020 Financial Stability Report, in which it devotes a section to the implications of climate change on financial stability. The biggest concern to the Fed is the abrupt repricing events and direct losses related to climate change and extreme weather incidents (specifically in real estate), where households and business could find themselves over-levered and the value of their assets impaired.

## ESG & Economy

As it relates to Sustainability/ESG and economic policy, the Biden administration has made clear its intention of involving the United States in the Paris Climate Accord once again. The new administration is also looking into dedicating $2 trillion in government spending over four years to upgrade millions of buildings and construct electrical vehicle infrastructure (among other green projects) with the goal of achieving net-zero emissions by 2050.

This is a much more aggressive target than the one under Obama which had aimed for 80% by 2050. It remains to be seen how this fully plays out economically and politically, as Democrats have a small majority in the House and control of the Senate will be determined after the January 2021 run-offs in Georgia. Biden's plan henceforth will require more compromise, with the very real possibility that the planned $2 trillion in green spending will be quickly whittled down into something less impactful or absorbed as part of another stimulus package.

## Bottom Line

- Given the SEC's mandate to protect investors (and bipartisan discussion) we expect guidance on ESG fund labeling.
- More discussion on standardized ESG reporting.
- Further Central Bank focus on ESG—Europe to lead in the near-term.

**Further Resources**

- Commissioner Allison Herren Lee, "Playing the Long Game: The Intersection of Climate Change & Financial Regulation" https://www.sec.gov/news/speech/lee-playing-long-game-110520
- "Q&A: Governor Raskin on Why US Regulators must address climate risk", Responsible Investor: https://www.responsible-investor.com/articles/q-and-a-governor-raskin-on-why-us-regulators-must-address-climate-risk
- Federal Reserve Bank Financial Stability Report: https://www.federalreserve.gov/publications/files/financial-stability-report-20201109.pdf
- ECB Sustainability Bond Purchases: https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200922~482e4a5a90.en.html
- Kevin Stiroh EVP Fed Reserve Bank, "A Microprudential Perspective on the Financial Risks of Climate Change.": https://www.newyorkfed.org/newsevents/speeches/2020/sti201110
- "The Biden administration: Top staff and Cabinet contenders" : https://www.newsbreak.com/news/2104222148459/the-biden-administration-top-staff-and-cabinet-contenders

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