Biden Climate Plan Ushers In New Compliance Considerations

By **Peter Kelso and Drew Howard** (March 15, 2021)

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President Joe Biden's multipronged climate plan and actions in his first months in office suggest his administration is likely to follow the European Commission's lead in increasing financial disclosure requirements related to environmental and climate risk.

In his first few days as president, Biden has reinstituted many of the environmental measures and protections that were rolled back by former President Donald Trump and unveiled a series of executive orders and plans to address climate change and environmental regulation.

These measures include rejoining the Paris Agreement, rescinding the permit for constructing the Keystone XL pipeline and establishing climate change as a national security priority.[1] Overall, Biden's estimated $2 trillion climate change plan will transcend his presidency by seeking to eliminate all carbon emissions from the U.S. energy sector by 2035, and making the country carbon neutral by 2050.[2]

Biden's plan may seem ambitious to some, but his administration has already assembled many of the necessary pieces to begin executing his environmental strategy. The administration has established a climate task force and Biden has made several key appointments that will bring a sense of urgency and a heightened focus on climate change to his administration.[3]

Biden has also begun working on regulatory issues across several federal agencies and departments including the U.S. Securities and Exchange Commission, U.S. Environmental Protection Agency and U.S. Department of the Treasury.

These agencies look to play prominent roles in establishing the financial and environmental disclosure instruments that will guide and enforce the compliance provisions of Biden's climate plan.

Despite the environmental framework that Biden has introduced, the true impact of his plan to transform the country's environmental economy — and how quickly that change could occur — is still a bit murky for corporate America.

The uncertainty over potential changes to existing state and federal environmental regulations, and the enforcement of those new rules, raise a lot of questions regarding what standards may be set that will mandate how companies address and disclose environmental concerns.

Adding to the pressure for companies to understand and adapt to Biden's environmental plans are investor demands that companies comply with emerging environmental, social and governance, or ESG, standards. ESG standards attempt to measure the overall societal impact of a company's financial performance and determine the sustainability of an investment asset.

Currently, sustainable investing assets in the U.S. have grown to over $17 trillion,

representing 33% of the total U.S. assets under professional management.[4] Worldwide, total assets exceed $30 trillion and the focus on ESG in the overall investment community and public continues to grow.[5]

In response to this proliferation of interest in ESG, there has already been a series of ESG regulatory and investment standards established in Europe and elsewhere around the world to measure ESG disclosure and compliance.[6]

For impacted industries in the U.S., the key considerations are how and when Biden will execute his climate plans and begin to implement a green economy, and what impact those changes will pose to U.S. business and investment.

This article focuses on the "E" in ESG and explores (1) the Biden administration's plan for climate change, (2) the recent establishment of ESG standards in Europe, (3) proposed ESG regulations and legislation in the U.S., and (4) the potential environmental and economic impact of Biden's plan on corporate America.

Biden's Climate Plan

In the race for the 2020 presidency, Biden campaigned on an aggressive pro-environmental platform, promising large-scale action to combat climate change.

Biden's current plan is a departure from the environmental policy of former President Trump, who rolled back over 100 environmental regulations during his four years in office, and more comprehensive than the climate policy that was introduced during the eight years of former President Barack Obama's administration.[7]

Biden has tied his climate plan to his economic policy of growth and job creation for green jobs and thus far, the plan appears to have received support from certain segments of industry, as well as from interested parties on both sides of the aisle.[8]

The primary tenets of Biden's plan are (1) stricter environmental standards and regulations, including more rigorous pollution limits on emissions, (2) enforcement mechanisms, and (3) environmental justice.

It is expected that Biden will more clearly define new proposed environmental standards over the coming months as well as his platform for ensuring environmental justice. The enforcement mechanisms of Biden's plan are anticipated to make polluters bear the full cost of the carbon pollution they are emitting and require public companies to disclose climate risks and greenhouse gas emissions in their operations and supply chains.

The plan also seeks to restrict federal infrastructure investment dollars to those projects that reduce climate pollution, as much as possible, and target investments toward green building and infrastructure, risk mitigation research and development, and climate-resilient infrastructure design.

From a global perspective, the Biden climate strategy entails:

- Engaging other countries to focus on climate change;

- A worldwide ban on fossil fuel subsidies;
- Prohibiting financing from the Overseas Private Investment Corporation, the Export-Import Bank and the U.S. International Development Finance Corporation to coal-fired power plants;
- Pursuing a global moratorium on offshore drilling in the Arctic; and
- Making climate change a core national security priority.

In addition to these global initiatives, Biden's climate plan will include several domestic features to reduce the U.S. carbon footprint and improve the country's air and water quality. Some of these plan components include using the federal procurement system to move toward more energy efficient transportation, tightening the provisions of the Clean Air Act, and a goal of conserving 30% of America's land and water by 2030.[9]

Biden Appointments

Biden's proposed plan involves coordination with other countries and international organizations as well as putting the pieces in place domestically to execute the multipronged strategy.

As such, many of Biden's appointees are focused on climate change issues. One example is the appointment of John Kerry as special presidential envoy for climate. Kerry, a longtime climate change advocate, will now hold a cabinet-level position and sit on the National Security Council.[10]

In addition to Kerry, Biden has assembled the "largest team of climate change experts ever assembled in the White House," according to the New York Times.[11] Gina McCarthy, the Obama-era head of the EPA, will create a new White House office on climate policy; and David Hayes, former Obama and Clinton deputy interior secretary, will serve as special assistant to the president for climate policy.

These leaders and other appointees bring a range of experience; notably, McCarthy has specialized in mitigating emissions through regulation.[12]

The SEC is poised to play a large role in Biden's climate strategy, with Gary Gensler tapped to head the commission. Given the shifting political dynamic at the SEC, it is expected that the SEC will soon require disclosures in public securities filings related to environmental risks and emissions, now that the commission has a 3-to-2 balance in favor of Democrats.[13]

Further proof of the SEC's move toward ESG disclosure standards is an August 2020 open letter by SEC commissioner Allison Herren Lee favoring requirements for companies to disclose ESG risk, and advocating for "standardized, consistent, reliable, and comparable

ESG disclosures."[14] This standardization methodology is currently in place in Europe, creating uniform definitions and instructions for ESG reporting.

The EPA is also expected to have a role in setting standards and enforcing compliance in conjunction with Biden's climate strategy.[15] Biden's nominee to be the next EPA administrator, Michael Regan, continued to advance through the confirmation process on Feb. 3, 2021, by securing a 14-6 vote by the Senate Environment and Public Works Committee.[16]

If confirmed, Regan has stated that he is committed to tackling environmental justice and would reestablish science and transparency as core principles at the EPA. In addition to leading the environmental justice campaign, a high priority in the early part of Regan's term is expected to be restoring many of the environmental protections that were undone during the Trump administration.

Ultimately, the EPA's ability to move Biden's climate policy forward will be predicated on finding the right balance between rolling back the provisions Trump put in place and proactively advancing the Biden climate strategy.

In addition to the White House and federal agencies, other departments are turning toward climate change as well. Treasury Secretary Janet Yellen has reportedly created a new senior position of climate czar, who would head a new Treasury climate hub.[17] The position would address potential climate change-driven risks to the financial system. Yellen will look to engage on issues of climate change's impact to the U.S. financial system and may be involved in working with Biden on pricing plans if the administration decides to implement a carbon tax for polluters.

Yellen's focus on the financial impacts of climate change echoes the U.S. Federal Reserve Board's decision on Dec. 6, 2020, to join an international organization of banks and regulators focused on combating climate change and monetary risk through a coordination of the global financial system.[18]

The Rise of ESG Standards in Europe

Biden's efforts to implement climate standards in the U.S. arrive at a time when many countries and international organizations, including the EU, have already established ESG regulations.

In 2018, the European Commission released an action plan on sustainable finance to comply with their commitment to the Paris Agreement.[19] The action plan created a framework to incorporate ESG factors into investment decisions and work with the low-carbon goals of the Paris Agreement.

New sustainability rules are coming into force in the EU starting this month, including the EU Taxonomy Regulation and the Sustainable Finance Disclosure Regulation.

Both the EU Taxonomy Regulation and the Sustainable Finance Disclosure Regulation are, as the latter's name implies, disclosure-related requirements that attempt to create a uniform, rules-based approach to ESG for financial services participants.

The Taxonomy Regulation came into force on July 12, 2020, but will not start applying in practice until January 1, 2022.[20] It aims to create a standardized classification system for environmentally sustainable activities under the EU's sustainable finance regulations. This

common language will help investors and companies better understand the ESG landscape and make informed investment decisions.

The Sustainable Finance Disclosure Regulation came into force on March 10, 2021, and will impose a number of ESG disclosure and reporting requirements on financial services participants, such as asset managers and financial firms. It will require asset managers to disclose how sustainability risk will potentially impact financial products and how that risk is incorporated into investment decisions.

This commitment to ESG reporting and disclosure standards, along with their early action on regulation, has allowed Europe to dominate the global sustainable investment market. As of the first quarter of 2020, Europe held 81.7% of global sustainable assets, with the U.S. in second place, with 14.3%.[21]

Exploration of ESG Standards in U.S.

In contrast to Europe, the U.S. does not currently have any mandatory ESG standards and disclosure of ESG risk in public securities filings is voluntary. But although the U.S. may be seen as lagging Europe in establishing a formal ESG disclosure framework, there has been movement over the past year from the SEC and Congress to implement and legislate new ESG standards.

SEC Recommendations

On Dec. 1, 2020, the ESG Subcommittee of the SEC met to discuss potential recommendations to improve the standards used for ESG investing and the public disclosure of ESG risks. The commission was originally formed in early 2020 to review practices of ESG investment products, establish a uniform taxonomy, and make recommendations to the SEC's Asset Management Advisory Commission.

Based on the ESG subcommittee's initial investigation, the subcommittee issued three draft recommendations at the December 2020 meeting regarding issuer disclosure of ESG risks:[22]

- Require the adoption of standards by which corporate issuers disclose material ESG risks,
- Utilize standard setters' frameworks to require disclosure of material ESG risks; and
- Require that material ESG risks be disclosed in a manner consistent with the presentation of other financial disclosures.

The subcommittee noted that the current unguided and voluntary approach to ESG reporting standards over the years has not led to consistent and meaningful disclosures by corporate issuers to the investment community. As a result, the subcommittee advises mandating standards by industry that are akin to the generally accepted accounting principles.

Under the subcommittee's recommendations, the SEC standard framework for issuers will mandate (1) clearly articulated principles by which the issuer determines qualitative metrics regarding whether an ESG risk is material, (2) prioritize disclosure of ESG applicable to most issues, such as climate risk, and (3) mandate disclosure of all material ESG risks by all issuers.

The ESG subcommittee's final recommendations are anticipated by the end of the first quarter of 2021.

U.S. Department of Labor

Despite the growing interest in ESG by the public and investment community, calls for standardized ESG disclosures during the Trump administration were largely rejected.

One example is the Oct. 20, 2020, final rule by the U.S. Department of Labor on the financial factors in selecting plan investments under the Employee Retirement Income Security Act.[23]

Under the final rule, which went into effect on Feb. 16, 2021, the DOL added provisions to (1) confirm that ERISA fiduciaries must assess investments based strictly on pecuniary factors, (2) maintain its opposition to nonpecuniary ESG factors in the consideration of investment decisions, and (3) prohibit ERISA fiduciaries from taking on unnecessary risks to endorse ESG and other nonpecuniary goals.

As constructed, the rule effectively prevents ESG criteria and standards to be the sole consideration in making investment decisions for 401k plans, thus limiting social investments in funds that hold nearly $8 trillion.[24] During his first week in office, Biden signed an executive order calling for a review of the DOL's ruling.[25]

U.S. Legislation

In Congress, the recent stimulus deal approved in December 2020 included several environmental provisions to confront climate change including a reduction in hydrofluorocarbons, tax incentives for renewable energy sources, and an expansion of funding for carbon capturing initiatives.[26]

The passage of the stimulus with these environmental measures follows the introduction of several federal climate change related bills in 2019-2020. Many of these bills seek to shape the scope and speed of the interaction between public policy and ESG regulation.

In 2019, the ESG Disclosure Simplification Act was introduced into the U.S. House of Representatives Financial Services Committee.[27] The bill seeks to mandate disclosures by public companies of the link between ESG metrics and the issuers long-term corporate strategy, as well as the methodology used to apply the impact of ESG metrics.

The bill would require the SEC to establish a permanent Sustainable Finance Advisory Committee and define the ESG metrics that corporate issuers would report.

The Climate Risk Disclosure Act of 2019 is a more expansive Senate bill that seeks to require companies to disclose detailed information about their exposure to climate-related risks.[28]

Specifically, this bill proposes to direct the SEC to mandate that every public company within two years disclose (1) direct and indirect greenhouse gas emissions, (2) the total amount of fossil-fuel related assets that it owns or manages, (3) how its valuation would be affected if climate change continues at its current pace or if policymakers successfully restrict greenhouse gas emissions to meet the 1.5 degrees Celsius goal, and (4) its risk management strategies related to the physical risks and transition risks posed by the climate crisis.

Other ESG-related bills introduced in 2020 include the Sustainable Investment Policies Act and the Retirees Sustainable Investment Policies Act.[29][30] These bills would require investment advisers to adopt and implement policies to consider ESG factors when making investments.

The Impact of Biden's Climate Plan

It is clear from the first few months of the Biden presidency that new laws related to climate change and standards regulating the disclosure of environmental risk are on their way. The European experience and their initial establishment of ESG standards will be illustrative but may not be indicative of the standards that will be instituted in the U.S.

From all accounts, it appears that the catalysts that will drive how fast ESG disclosure standards are implemented in the U.S. will be (1) changes by the SEC to incorporate ESG standards into the existing reporting framework and (2) pressure from the investment community for established ESG metrics that guide investment decisions.

Given the current trajectory of interest in ESG, some of these changes may begin to occur as quickly as this year and it's reasonable to assume that disclosure standards in the U.S. may be defined and established during Biden's presidency.

Generally, the expectations are that the rise of ESG standards and laws directed at climate change will produce more stringent state and federal regulations. These regulations are likely to impact pollution and allowable emissions, the redevelopment of new and existing properties and will ultimately affect transactions in M&A, bankruptcy and other deals that involve ESG-related assets.

Restrictions for companies to access public finance and insurance due to environmental concerns are also issues looming on the horizon. Biden is expected, among other actions, to force agencies to calculate the cost of carbon dioxide as it pertains to society, or the social cost of carbon.[31] This calculus will raise the costs of climate change and related pollution, and in turn may increase the likelihood of regulatory lawsuits.

In advance of a government or investment-driven ESG mandate, companies can proactively take steps to ensure they are moving toward greener operations and developing an environmental management plan. Some of these steps can include:

- Tracking changes in the U.S. regulatory environment and global ESG standards to ensure proper financial disclosures of environmental risks;

- Performing environmental assessments of their operations and facilities to measure if those risks are material and should be financially or otherwise disclosed;

- Assessing levels of carbon emissions from existing operations;

- Adapting by investing in new technologies to limit and capture emissions or developing new, renewable energy sources; and

- Joining industry alliances that promote science behind any regulatory or legislative changes that are enacted.

Ultimately for corporations, it will be imperative to monitor and understand the evolving regulatory landscape and expand their strategic horizon to look at the economic impact of environmental risks 10, 20 and even 30 years into the future.

Being able to model the economic impact of these risks, in conjunction with potential shifts in government regulation, will be important for corporations to understand how to comply with new ESG standards and how best to address environmental issues that affect their balance sheet and the sustainability of their operations.

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