NEAM VANTAGE POINT

Quick Takes

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TIMELY TOPICS FOR INSURANCE EXECUTIVES

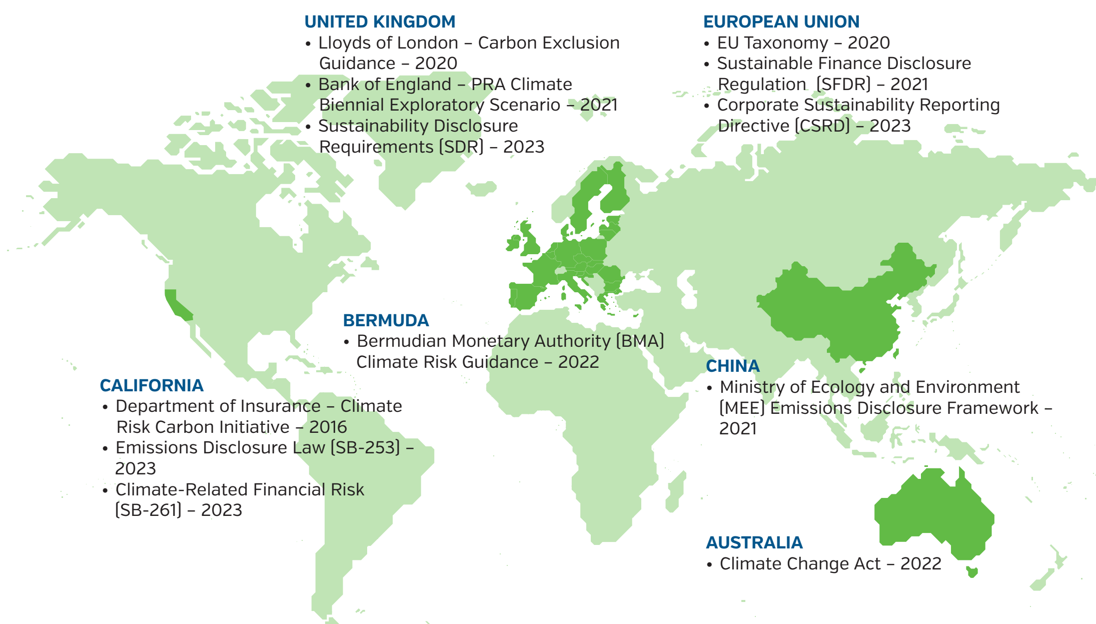
IN THIS ISSUE ▸

Is the Climate Changing on Climate Change Regulation?

A heat check for climate change regulation.

In the last several years, a tremendous amount of energy has been spent by various regulators, government agencies, trade organizations and other governing bodies around the world to put in place a myriad of mandatory regulations and voluntary guidelines relating to ESG, largely focused on climate change.

Exhibit 1. Sampling of Climate Risk Related Regulation



Source: NEAM

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Of late, however, it seems further regulation related to climate change, even outside the US, has been increasingly delayed, softened, or withdrawn all together.

SEC's Climate Disclosure Rule: Initially proposed in March 2022, the rule was not finalized and released until two years later after being substantially reduced in scope and is now embroiled in litigation.

EPA's New Vehicle Emissions Standard Rule: Released in March 2024, the rule softened vehicle emissions standards by giving carmakers more time to ramp up EV sales.

Federal Insurance Office (FIO): In the first quarter of 2024 the FIO abandoned its proposal to collect data on climate-related risks from property and casualty insurance companies.

EU's Corporate Sustainability Due Diligence Directive (CSDDD): This regulation (which addresses more than just climate change) requires companies to investigate and address how their operations and supply chains impact the environment and human rights. Final approval came in March 2024 after a long delay and intense negotiations during which the directive was substantially softened to gain approval.

Australia's Mandatory Disclosure on Climate Risk and Emissions: Originally to go into effect July 1, 2024, it is expected to get pushed back 6 to 12 months.

How do we explain this seeming loss of momentum and apparent pullback in climate regulation at a time when scientists are calling for more urgent action?

Undoubtedly, it is related to the ***broader pushback on all things ESG*** which is for the most part a US phenomenon. The anti-ESG crowd has exerted significant influence in the US that has had global impact. Their legal threat led to a mass exodus of members from the Net Zero Insurance Alliance (NZIA) in the first half of 2023. This movement has also managed to enact laws in many states that have banned a number of financial companies focused on the energy transition from doing business in their states. This show of force has caused companies that once proudly promoted their climate work to rethink their strategy and to scale back on participation in international climate agreements.[1] This anti-ESG sentiment in the US is largely due to partisanship. As former South Carolina Republican Congressman Bob Inglis confessed,

"I didn't know anything about climate change except that Al Gore was for it. Therefore, I was against it."

But is this all just politics? Not entirely.

There is a ***material cost*** to complying with these regulations without agreement on the actual benefit. The SEC alone has estimated annual costs to comply with their ruling to be approximately $500,000 depending on firm size.[2] These costs, for the additional staff needed to track carbon emissions, purchase new software, and hire expert consultants, are material for small companies and could discourage young companies from entering the public market at a time when the number of publicly traded companies is shrinking.

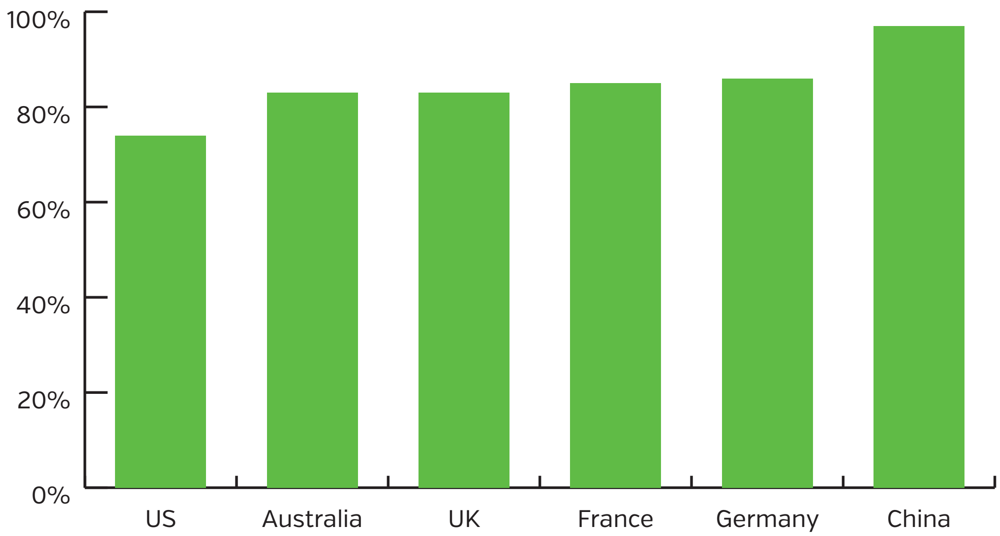
Aside from the additional costs, some argue that the red tape and ***administrative burden*** of tracking and disclosing emissions causes inefficiencies and a loss of focus that could ultimately hinder economic development.

Others argue on purely ***philosophical grounds***, saying these climate regulations are governmental overreach and encumber independence. As it relates to the SEC ruling, opponents say it goes beyond the bounds of the agency's mandate.

One of the more significant reasons for the climate regulation pushback is the ***worry of future economic viability*** by those that stand to lose the most in the global decarbonization effort. They realize that if there is more emphasis placed on climate risks and emissions that their industries will face more pressure to change, shrink, or be eliminated entirely. How bright is the future for a company that currently derives 100% of its revenues from acquiring and selling fossil fuels in a world that is looking to transition away from such fuel sources? Even companies in less carbon-intensive sectors that had enthusiastically committed to aligning their entire operations with net zero goals are having second thoughts as the real-world ramifications of acting on those pledges within the specified timelines becomes painfully apparent.

When considering public opinion, the pause in regulation is a bit surprising since numerous surveys[3] indicate that people, even in the US, are generally supportive of governments taking action to address climate change. However, people's willingness to absorb higher costs and increased inconveniences necessary to actually deal with climate change remains to be seen.

Exhibit 2. Percent Saying Government Should Do More to Address Climate Change



Source: University of Bonn, the Leibniz Institute for Financial Research SAFE in Frankfurt and the University of Copenhagen

With no end to the political polarization in sight, it's hard to imagine the anti-ESG campaign subsiding anytime soon. In fact, depending on the outcome of the US presidential election in November the anti-ESG campaign could increase further. Therefore, we would expect continued resistance to climate related regulation in the US in the near term. Despite the recent delays, we expect that Europe and most other regions will press ahead into the next stages of climate regulation. In any case, US companies will be required to disclose climate risks and emissions anyway if they intend to operate in these foreign markets.

KEY TAKEAWAYS

- The climate has clearly cooled for climate change regulation in the US.
- There are several reasons why climate regulation has encountered a bit of a pullback: politics, costs, administrative burdens, and the worry of future economic viability.
- Climate change regulation should continue moving forward in much of the world but will likely face continued resistance in the US.

ENDNOTES

[1] In 1Q24 some of the largest asset managers in the US --JPMorgan, State Street, Invesco, PIMCO and Blackrock's US business -- withdrew from Climate Action 100+, an investor-led initiative to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change.

[2] Eaglesham, Jean, and Paul Kiernan. Fight Brews Over Cost of SEC Climate-Change Rules. The Wall Street Journal. 17 May 2022. https://www.wsj.com/articles/fight-brews-over-cost-of-sec-climate-change-rules-11652779802 .

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[3] Andre, P., Boneva, et al. Global Survey Shows: Broad Majority of Global Population Supports Climate Action. Uni Bonn. 12 February 2024. https://www.uni-bonn.de/en/news/weltweite-befragung-zeigt-breite-mehrheit-der-weltbevoelkerung-fuer-den-klimaschutz.

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