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How the Impending Regulatory Overhaul in the Financial Sector Adversely Impacts the Energy Space

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The Recent ESG Backlash Should Not Provide the Hydrocarbon Industries a False Sense of Security

Two things can be true at once, particularly in the ESG world. Recent ESG criticism, i.e., the "anti-ESG" movement[1], is currently recalibrating the perceived utility of the ESG ecosystem. While there will remain a long-term benefit to ***material*** ESG-related data and disclosure, it is fair to say the topic probably garnered a ***disproportionate*** share of attention within the capital markets over the last half-decade. Fortunately, as the market begins to cool and valuations are anticipated to correct[2], several active (as opposed to index) investors are correctly reprioritizing capital discipline, ROI, and excess alpha ahead of ESG-related considerations. That said, assuming this reversion provides a unique immunity or a distinct end to ESG-related mandated reporting would be incorrect.

Anti-ESG efforts are not alleviating the dogmatic pressures relentlessly determined to integrate further anti-fossil fuel strategies within the capital markets. Fossil fuel detractors command the ESG integration movement within the regulatory landscape. As a result, rational procedural policy is quietly but efficiently being replaced with idealistic and arduous doctrine. This conclusion and our corresponding advice are founded upon three unique developments brewing in the regulatory world:

- Our internal analysis of shareholder activism in the financial sector over the last eighteen months indicates a concerted attempt to **restrict banking access** to the hydrocarbon industries.
- The regulatory environment for the banking industry is currently experiencing an attempted overhaul intended to **integrate anti-fossil fuel tenets into debt underwriting *permanently***.
- **Future insurability is the "silent domino"** whose respective regulators are quietly incorporating extensive ESG-related disclosures and anti-fossil fuel strategies into governing policies and underwriting guidelines.

Regardless of the mounting political controversy besieging the existing utilization of ESG, influential regulators and motivated anti-fossil fuel shareholder advocacy groups remain undeterred in their collective efforts to eliminate the hydrocarbon space. Hydrocarbon companies must strategically prepare for their insistent attempt to permanently integrate anti-fossil fuel regulatory policies under the ulterior cloak of ESG evaluation.

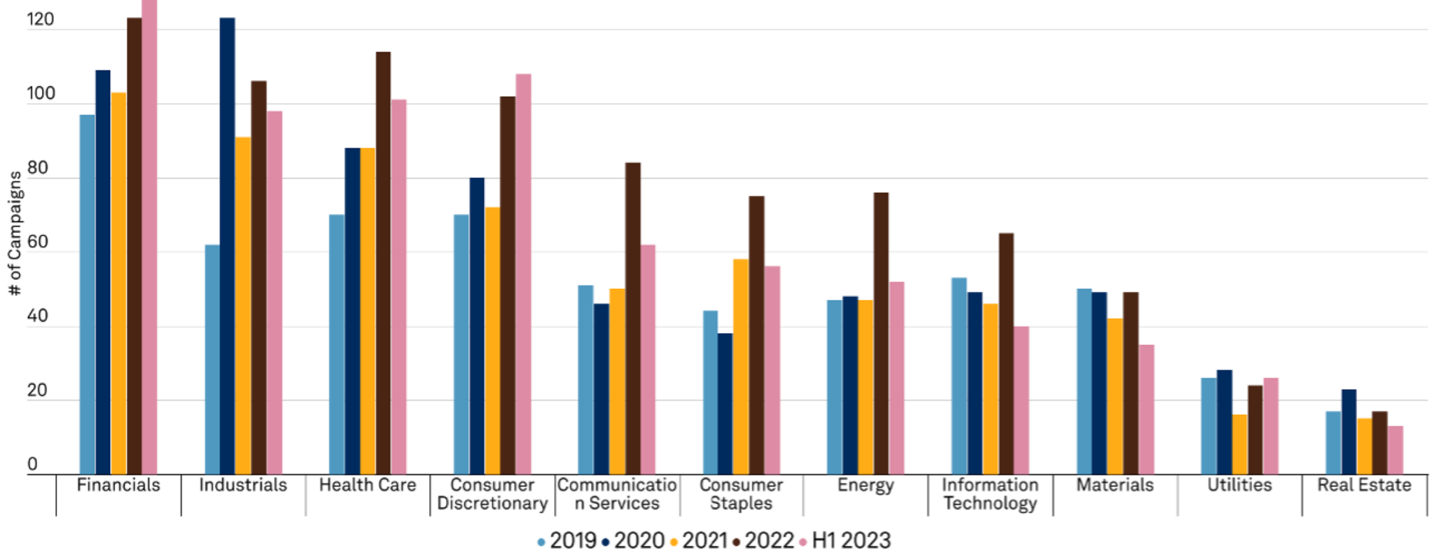
[1] https://www.morningstar.com/sustainable-investing/whos-behind-rights-anti-esg-campaign
[2] The current probability of a U.S. recession is approximately 66%

Shareholder Activism Within the Financial Sector Directly Impacts Energy's Future Access to Capital

ESG's impact on the equity markets, especially the Energy sector, is nothing new. What is relatively new, however, is the indirect attempt by motivated equity shareholders and partnering NGOs to penalize the broader energy space by inherently affecting the Financial sector. Index investors, acting in concert with activist investors and climate action groups, are increasingly influencing U.S. and European banks to accelerate their respective climate actions by reducing their lending to the oil and gas industry.

ESG ACTIVIST CAMPAIGNS BY TARGET INDUSTRY

The Industrials sector saw the highest increase in ESG-related activist campaigns between FY 2019 and H1 2023 with a 58% increase, followed by Consumer Discretionary and Healthcare with 54% and 44%, respectively.



Source: S&P Capital IQ data as of July 28, 2023. Campaigns include launched / announced publicly by an activist firm against target company with primary industry disclosed.

Shareholder activism over the last 18 months has centered on the Financial Sector. [3]

Hydrocarbon companies must monitor shareholder activism in the Financial sector since those respective engagements carry a more significant ripple effect than conventional shareholder activism in the Energy sector. Over the last five years, investor activism in the Financial sector has been comparatively muted. However, the Financial sector has experienced the highest number of activist engagements over the previous two years, and the vast majority of engagements have centered on overall hydrocarbon financing[4]. Financials' current epicenter of activism lies in Europe – where banks and insurers face immense pressure to decarbonize and divest from fossil fuels. Lloyds and HSBC face the most pressure to commit to ceasing financing of new oil and gas fields[5]. Many believe U.S. banks will begin experiencing similar demands in 2024 based on what they are already starting to endure throughout the first half of 2023[6].

[3] https://pages.marketintelligence.spglobal.com/Investor-Activism-Infographic-FY22.html
[4] https://pages.marketintelligence.spglobal.com/rs/565-BDO-100/images/investor-activism-h1-2023.pdf
[5] https://www.reuters.com/business/finance/uks-lloyds-ditches-project-finance-new-oil-gas-fields-2022-10-20/
[6] https://www.insightia.com/in-depth-the-big-esg-proposals-of-2023-2/

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In January 2023, The Interfaith Center on Corporate Responsibility (ICCR), an incredibly influential shareholder advocacy group, revealed its members had submitted proposals to six major fossil fuel financers, seeking net-zero transition plan reporting and fossil fuel financing phase-out commitments[7]. ICCR works closely with NGOs and civil society groups to ensure that corporate engagement strategies integrate the perspectives of "impacted communities."

ICCR's advisory council includes representation from BNP Paribas, Robeco SAM, Boston Common Asset Management, and BMO Global Asset Management.[8] Analysis of their proxy resolutions and voting guide[9] displays a distinct anti-fossil fuel agenda. Their website states, "Financing by banks and insurance companies is helping prolong the dominance of fossil fuels in our energy supply and delay the transition to clean energy. While several major banks have begun acknowledging their role in exacerbating climate risk, few have changed their lending policies to mitigate that risk."[10]

Fossil fuel detractors' collective strategy does not necessarily target just the energy sector. Instead, their foundational philosophy is to place immense pressure on the groups which finance and insure them. Ironically, the so-called energy "transition" will require a colossal amount of incremental capital, and the populations best qualified to innovate, commercialize and scale functional renewable technologies reside in the fossil fuel industries. That economic logic is being ignored, and the prevailing thesis on the utility of renewables remains incorrect and biased. An uncompromising mindset now drives regulatory policy obsessively fixated solely on fossil fuel divestment instead of feasible solutions that minimize the adverse impacts of the energy "addition." Unfortunately, commercializing and scaling reliable, functional, and affordable energy sources remains a lesser priority to these groups.

This mindset has been quickly penetrating the investor landscape over the last year. The Financial sector experienced the filing of nine proposals at top U.S. banks and seven proposals with significant insurance companies calling for "greater accountability in climate lending." Shareholders of major U.S. and Canadian banks are continually pressured by climate action groups to act on global net zero targets by requiring a reduction in fossil fuel lending and to publish interim emissions reduction targets for 2030[11].

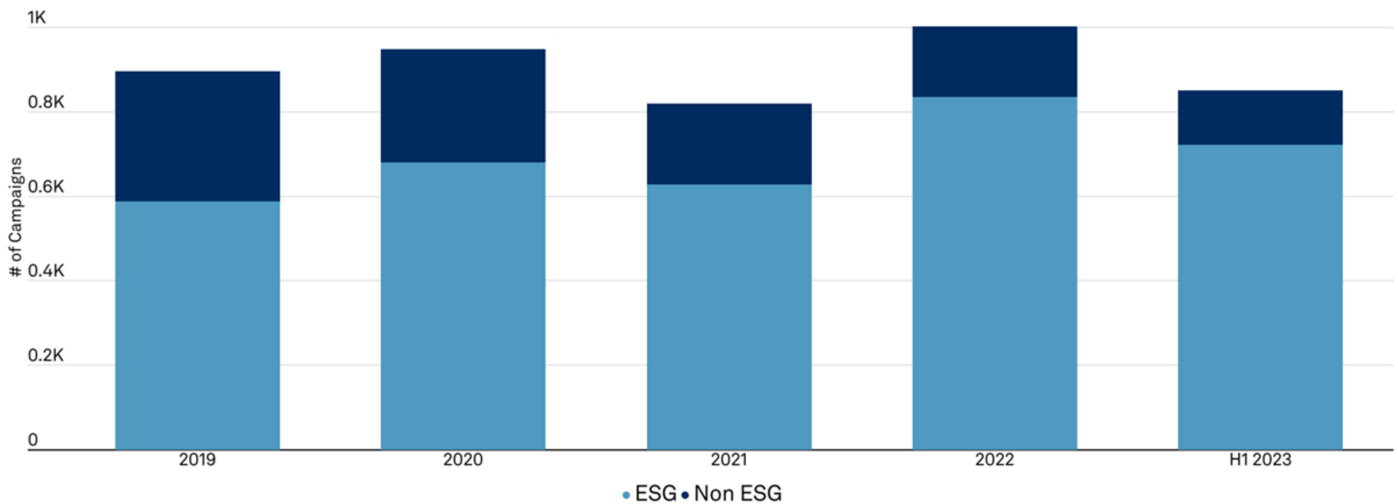
A resolution on financing consistent with the IEA Net-Zero 1.5° Scenario was filed at Bank of America, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley, and Wells Fargo[12]. Bank of America and Citigroup also received resolutions requesting an audited report on the impact of the 2050 IEA net-zero emissions scenario[13]. JPMorgan Chase also received a proposal requesting a report on absolute emissions reduction aligned with the IEA Net-Zero Emissions by 2050 Scenario. Several Canadian banks, including the Bank of Montreal, Royal Bank of Canada, and Toronto Dominion, likewise received resolutions addressing financing consistent with a net-zero by 2050 scenario, avoiding bank participation in pollution-intensive asset privatization and the integrity of the sustainable finance definition[14].

[7] ICCR 2022 Climate Proposals in the Financial Sector.
[8] https://investorsforhumanrights.org/advisory-council
[9] ICCR 2022 Proxy Resolution & Voting Guide
[10] https://www.iccr.org/our-approach/what-we-do-how-we-do-it
[11] https://www.sgvoice.net/investing/24709/banks-feel-shareholder-and-activist-heat-on-fossil-fuel-lending/
[12] ICCR - Nine Proposals for 2022 Proxies Shareholders Seek to Move Top Banks to Cut Emissions/Fund Climate Solutions
[13] https://www.commondreams.org/news/fossil-fuel-finance-iccr
14https://www.insightia.com/in-depth-the-big-esg-proposals-of-2023-2/

Shareholder Activism Within the Financial Sector Directly Impacts Energy's Future Access to Capital

INVESTOR ACTIVISM CAMPAIGNS BY TYPE: ESG VS. NON-ESG

Investor activism campaigns reached an all-time high with 850 campaigns launched in H1 2023, following a busy year that saw the highest level of activist activity on record (762 campaigns in H1 2022). Of the total campaigns launched in H1 2023, 85% (721 in total) had an ESG component, the highest figure in the last 5 years.



Source: S&P Capital IQ data as of July 28, 2023.

The vast majority of shareholder activism over the last three years centers on ESG-related considerations.[15]

An added layer of complexity also enters the fold with the introduction of Universal Proxy rules, which are theoretically designed for institutional shareholders to "empower" their respective investors[16]. This is most evident with the "Big Three," where BlackRock, State Street, and Vanguard seek voting instructions from their investors. This will undoubtedly have unpredictable consequences for corporates as these "empowered" investors' voting habits and practices will be harder to predict than those of the institutional shareholders, most of whom have publicly stated their investment and governance goals and policies[17].

[15] *https://pages.marketintelligence.spglobal.com/Investor-Activism-Infographic-FY22.html*
[16] *https://www.blackrock.com/corporate/about-us/investment-stewardship/blackrock-voting-choice/proxy-voting-power-of-choice*
[17] *https://www.whitecase.com/insight-our-thinking/nine-developments-and-trends-shaping-us-shareholder-activism-2023*

Shareholder Activism Within the Financial Sector Directly Impacts Energy's Future Access to Capital

Universal proxy rules adopted by the SEC in November 2021 will require universal proxy cards in contested director elections. The likely impacts of universal proxy rule change on activism include[18]:

1. Making it **more accessible** for activists to get one or two nominees elected to boards

2. Increasing the **focus on individual candidates** and director qualifications rather than on entire slates

3. Making proxy contests more accessible and more affordable, thus **encouraging more minor activists** with fewer resources to pursue ESG-related campaigns - presumably climate and human capital management

4. Providing activists with **greater negotiating leverage** with target companies even without launching proxy contests, i.e., a more "affordable" method of shareholder activism

5. Encouraging companies to **adopt bylaws** that facilitate the use of universal proxy cards

The apparent consequence of the "shareholder choice-universal proxy card" combination is that less informed and more emotionally charged clients will vote based on individual impulses that satisfy a personal agenda instead of remaining objectively focused on long-term value creation. One must also appreciate the unfortunate irony of this dynamic. Index eligibility generally does not consider the underlying or forecasted fundamentals, future strategy, and management pedigree.

Index management is commonly called "passive" since high-level characteristics, namely market cap, sector, and region, typically determine portfolio construction for their respective vehicles. BlackRock's equity index alone has $4.5 ***trillion*** in AUM, which equates to an ability to cast 10% of the shareholder votes for the entire S&P 500[19]. Accordingly, there is absolutely nothing "passive" about index funds or ETFs, particularly those managed by any of the Big Three.

We respectfully feel it is naïve and misguided to believe any of the Big Three will cater to anti-ESG momentum. As of October 2022, over $1B has been withdrawn from BlackRock by a collective of anti-ESG state treasurers[20]. That is a substantial amount of AUM, and that trend among those parties will most likely continue. However, that pull-out is barely 1% of BlackRock's overall assets and pales compared to the firepower displayed by the "Race to Zero" global campaign[21]. For additional context, Bloomberg estimates the $4 trillion ESG debt market today will swell to $15 trillion by 2025, while total ESG assets surpassed $35 trillion in 2020[22]. Even if half of the ESG market were reclassified as non-ESG due to greenwashing, there would still be $17,500 of ESG assets for every anti-ESG dollar withdrawn.

> *Race To Zero is a global campaign ... It mobilises a coalition of leading net-zero initiatives, representing* ***11,309 non-State actors including 8,307 companies, 595 financial institutions, 1,136 cities, 52 states and regions, 1,125 educational institutions and 65 healthcare institutions (as of September 2022)****. These 'real economy' actors join the largest-ever alliance committed to achieving net zero carbon emissions by 2050 at the latest.* ***United Nations Climate Change, Race to Zero***

Rank	Company	Country	Total AUM, US$b	Balance sheet
1	BlackRock	US	9,570	03/31/2022
2	Vanguard Group	US	8,100	03/31/2022
3	Fidelity Investments	US	4,283	03/31/2022
4	State Street Global Advisors	US	4,020	03/31/2022
5	Morgan Stanley	US	3,320	03/31/2022
6	JPMorgan Chase	US	2,960	03/31/2022

World's Top Asset Management Firms, Adv Ratings, *retrieved 10 December 2022**

The total combined AUM of BlackRock, SSGA & Vanguard is approximately 22,000x greater than the amount of AUM withdrawn by anti-ESG state treasurers.[23]

[18] *https://www.whitecase.com/insight-our-thinking/nine-developments-and-trends-shaping-us-shareholder-activism-2023*
[19] *Blackrock and its ESG Voting Choice "Ruse"*
[20] *https://nationalfile.com/republican-states-withdraw-1-billion-from-blackrock-over-far-left-esg-policies/*
[21] *Anti-ESG State Treasurers Withdrawing Funds From BlackRock*
[22] *https://www.bloomberg.com/company/press/esg-may-surpass-41-trillion-assets-in-2022-but-not-without-challenges-finds-bloomberg-intelligence/*
[23] *https://unfccc.int/climate-action/race-to-zero-campaign#eq-1*

The Impending Banking Regulatory Environment Will Compound Existing Investor Pressures on Energy

The adverse impacts of ESG brewing within the impending banking regulatory environment have unfortunately not received the same degree of attention as the developments in the equity markets. The banking industry is experiencing an aggressive but quiet onslaught of new regulatory developments, particularly those deriving within the Department of Treasury and Federal Reserve. This bureaucratic clutter comes across as dogmatically idealistic instead of constructively beneficial and economically sound. As more matter of fact - it is a wolf wearing sheep's clothing. In any case, there are three distinct bureaucracies all energy corporates, both public and private, must be aware of:

1. The Financial Stability Oversight Committee ("FSOC")

The FSOC was established by the Dodd-Frank Act in 2010 to protect the U.S. economy from the actions of large banks that were considered responsible for the Great Recession. The central objective of FSOC is to assess, monitor, and mitigate risks to the overall stability of the financial markets within the United States. The Secretary of the Treasury chairs it, and the committee consists of 10 voting members and five nonvoting members[24], bringing together the perspectives of federal financial regulators, state regulators, and an independent insurance expert appointed by the President[25]. Cynically, "independent" within "independent insurance expert" is most likely subjective and partisan. In the most explicit of terms, the FSOC has explicitly stated, "Climate change is a threat to U.S. financial stability."[26]

As it relates to climate finance, The FSOC is perhaps best known for its 133-page report directed by President Biden that concluded, "There is a substantial amount of work that needs to be done to tackle climate-related risks, and calls on financial institutions, public companies, and regulators to work together to develop a common agenda to respond to climate change."[27]

This report also published a **Fact Sheet** as an accompaniment to the report to summarize its findings. The key recommendations from the report aim to "support the ongoing and urgent whole-of-government effort to address climate change."[28]

In particular, the FSOC fact sheet sets out four key recommendations:

1. Building capacity and expanding efforts to address climate-related financial risks
2. Filling climate-related data and methodological gaps
3. Enhancing public climate-related disclosures
4. Assessing and mitigating climate-related risks to financial stability

2. The Federal Reserve's Supervision Climate Committee ("SCC")

The "SCC" brings together senior staff from the Federal Reserve Board and Reserve Banks across the System to ensure supervised firms are "resilient to climate-related financial risks Basel Committee's Task Force on Climate-Related Financial Risks[29]." The Federal Reserve Board explains that the SCC's micro-prudential work is intended to ensure the safety and soundness of financial institutions by preparing for the economic and financial consequences of climate change[30]. The individual running point for the SCC is Kevin Stiroh, the former Head of New York Fed Supervision. Based on our analysis, the Federal Reserve Bank of New York has traditionally run point on pushing climate-change-related studies throughout the U.S. banking system.[31]

This appointment was intended to showcase how the Fed focuses on climate change as an area to monitor potential risks to the financial system closely. This move coincided with the Fed's announcement that it had joined an international central bank group devoted to climate change[32]. The group is the Network of Central Banks and Supervisors for Greening the Financial System (NGFS)[33] – highlighting the growing ***international*** influence of banking policy within the United States.

[24] https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/financial-stability-oversight-council/about-fsoc/council-members
[25] https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/fsoc
[26] FSOC: Climate change is threat to US financial stability
[27] https://home.treasury.gov/system/files/261/FSOC-Climate-Report.pdf
[28] https://home.treasury.gov/system/files/136/FACT-SHEET-The-Financial-Stability-Oversight-Councils-Response-to-Climate-Related-Financial-Risk.pdf
[29] https://www.frbsf.org/our-district/about/climate-risk/
[30] https://www.mayerbrown.com/en/perspectives-events/publications/2021/03/us-federal-reserve-announces-new-climate-committee-and-provides-more-guidance-on-its-approach-to-addressing-climate-change-risks
[31] https://www.newyorkfed.org/research/conference/2022/climate-change
[32] https://www.reuters.com/article/usa-fed-climate-idUSL1N2K02GM
[33] https://www.ngfs.net/en

The Impending Banking Regulatory Environment Will Compound Existing Investor Pressures on Energy

3. The Financial Stability Climate Committee ("FSCC")

This committee is described as complementing the work of the Fed's Supervision Climate Committee. It is "charged with developing and implementing a program to assess and address climate-related risks to financial stability."The new committee will coordinate with the Financial Stability Oversight Council (FSOC), its member agencies, and the Fed's community development, payments, international coordination, and economic research and data areas to develop a coordinated approach. The committee chair, Lael Brainard, emphasized that the Fed is committed to increasing its capacity "to understand and address the risks, complexities, and challenges related to climate change within the Federal Reserve's responsibilities."[34]

In the March 19th, 2021, FEDS notes, the FSCC expressed:

> *"First, the Federal Reserve's financial stability monitoring framework is flexible enough to incorporate many key elements of climate-related risks broadly. Second, although we believe that climate change increases financial stability risks, more research and analysis are needed to incorporate these risks fully into financial stability monitoring,* ***including substantial improvements in data and models.*** *Third, domestic and international transparency efforts around climate-related financial exposures may help clarify the nature and scope of financial stability risks related to climate change."*[35]

This statement should concern the Energy sector for three distinct reasons. First, it showcases that, for the first time, climate-related considerations are becoming permanently embedded within the bloodstream of the regulatory market. Secondly, there is an explicit acknowledgment that the existing quality of ESG-related data is poor and requires immense improvement. Lastly, it showcases how international decisions continue to trickle into U.S. policy adversely. We feel this will have the most significant impact on regional banks since a variety of decision-autonomy will be eliminated from their respective disposal via regulatory decree. We also empirically know that a tremendous amount of biased data exists in the ESG ecosystem[36], placing an increased onus on corporates to provide ESG-related data themselves.

[34] *Fed establishes Financial Stability Climate Committee*
[35] *https://www.federalreserve.gov/econres/notes/feds-notes/climate-change-and-financial-stability-20210319.html*
[36] *https://www.pickeringenergypartners.com/media/wp-paragraph-p-p-wp-paragraph-wp-paragraph-p-p-wp-paragraph-wp-paragraph-p-p-wp-paragraph*

The Energy Sector Must Prepare for the Insurance Industry's Inevitable "Silent Domino"

That silent domino, of course, is the budding overlap evolving between shareholder activism and the insurance industry. In June 2023, the U.S. Department of the Treasury's Federal Insurance Office (FIO) released a report entitled, Insurance Supervision and Regulation of Climate-Related Risks[37]. The report, in response to President Biden's Executive Order on Climate-Related Financial Risk[38], assesses climate-related issues and gaps in the supervision and regulation of insurers. The states primarily regulate insurance in the United States. However, Congress established the FIO through the Dodd-Frank Act in 2010 to essentially oversee the activity of state insurance regulators at the federal level. The FIO is the only federal entity mandated to monitor all aspects of the nationwide insurance industry[39].

The Insurance Supervision and Regulation of Climate-Related Risks report, which is only one of several steps FIO is taking to assess climate-related risk to the insurance sector, finds that there are critical existing efforts to incorporate climate-related risk into state insurance regulation and supervision. As a result, the report encourages state insurance regulators and the National Association of Insurance Commissioners (NAIC) to build on climate monitoring and disclosure progress.

We feel there are five key recommendations released in the report to highlight[40]:

1. State insurance regulators and the NAIC should build on their initial steps and **expand their work on climate-related risks** to promote increased regulatory uniformity among the states in considering such risks.

2. State insurance regulators and federal authorities should encourage insurers to **capture more granular, consistent, comparable, and reliable data** on climate-related risks.

3. All state insurance regulators should develop and **adopt climate-related risk monitoring** guidance appropriate for their markets.

4. The NAIC and state insurance regulators should guide on and encourage insurers to **implement ongoing climate risk monitoring.**

5. State insurance regulators should **require insurers** to incorporate climate-related risks into both ORSAs and ORSA Summary Reports[41]

The ripple effect of these recent developments is also seeping into Senate hearings. In June 2023, the Senate Budget Committee sent letters to seven insurance companies or owners of insurance companies – State Farm, Liberty Mutual, Berkshire Hathaway, AIG, Travelers Insurance, Chubb, and Starr – demanding answers and internal information about how each company underwrites, invests in and profits from the fossil fuel industr[42]. The inquiry also seeks their plans to follow the Paris Agreement's commitment to lessening global warming and their methodologies and projections for rates and coverage related to climate harms.

Shareholders also filed climate resolutions in January 2023 at four companies (Chubb, Travelers, The Hartford, and Berkshire Hathaway) that insure fossil fuel projects[43]. As You Sow, another influential shareholder advocacy group, filed a shareholder proposal last year asking Chubb to publish a report on whether and how it plans to measure and cut greenhouse gas emissions connected to its underwriting, insurance, and investing activities. Regarding shareholder activism within the Financials sector, management teams in the Energy sector must constantly be aware of the actions displayed by As You Sow, ICCR, Ceres, and Green Century. They have evangelized the fossil fuel divestment position and shown incredible influence in the regulatory and investor landscape. Insurance companies are amending their respective partnerships with fossil fuel companies not necessarily because they want to but because they are being coerced to.

For example, As You Sow has publicly stated they want Chubb to institute commitments that align with the Paris Agreement's goal of limiting global warming to 1.5°C by the end of the century. The group maintains that ***all*** greenhouse gas emissions must be eliminated or offset by 2050[44]. A majority of Chubb's shareholders backed the proposal[45]. That said, Chubb understandably stated that it did not know how to "reasonably measure" emissions from the entities it insures[46]. In other words, the feasibility of the goal, however arbitrary, is not the focus of shareholder advocacy groups like As You Sow. Instead, these groups remain fixated on absolute climate-related circumstances with little regard for the unintended consequences, financial requirements, or the economic feasibility of their stated objectives.

[37] https://home.treasury.gov/system/files/136/FIO-June-2023-Insurance-Supervision-and-Regulation-of-Climate-Related-Risks.pdf
[38] https://www.whitehouse.gov/briefing-room/presidential-actions/2021/05/20/executive-order-on-climate-related-financial-risk/
[39] https://content.naic.org/cipr-topics/federal-insurance-office-fio
[40] https://home.treasury.gov/system/files/136/FIO-June-2023-Insurance-Supervision-and-Regulation-of-Climate-Related-Risks.pdf
[41] The ORSA (Own Risk & Solvency Assessment) applies to any individual U.S. insurer that writes more than $500 million of annual direct written and assumed premium and/or insurance groups that collectively write more than $1 billion of annual direct written and assumed premium. An insurer that is subject to the ORSA requirements is expected to: 1) regularly, no less than annually, conduct an ORSA to assess the adequacy of its risk management framework and current and estimated projected future solvency position; 2) internally document the process and results of the assessment; and 3) provide a confidential high-level ORSA Summary Report annually to the lead state commissioner if the insurer is a member of an insurance group and, upon request, to the domiciliary state regulator.

Energy Companies Must Preemtively Prepare for The Ensuing Financial Sector Alteration

ESG evaluation, when focused on the material bottom-up differentiators of a hydrocarbon business, will provide incremental insight into the future competitive potential of a given asset. In some cases, prudent investors will seek material ESG-related data because it will assist in pinpointing valuation premiums and excess alpha. In other cases, they will request said data because they will be forced to, either by their respective investors or regulators. The critical point here is that intent at this point does not matter. One way or another, the broader capital markets spectrum will increasingly demand quantifiable trending non-fundamental data points.

Perhaps the most frustrating rub lies in the fact that anti-fossil fuel evangelists will also continually engineer a counter-evaluation to any existing pragmatic hydrocarbon valuation – and will most likely exhaust efforts to promote divestment strategies by layering on broader non-material ESG-related factors to fulfill their respective divestment convictions. Focusing on intent is the strategic equivalent of playing checkers. Successful navigation of the revised impending capital markets requires a management team to play ESG chess, meaning reacting to one ESG move at a time is no longer a sound option.

One way or the other, the hydrocarbon companies and their capital providers will remain under constant monitoring by an unfriendly audience. Suffice it to say control of that monitoring lies in the hands of a population whose majority remains emphatically fixated on directly or indirectly implementing divestment tactics. Successful navigation of this revised landscape requires five distinct action items:

1. Hydrocarbon companies must be honest and realistic with the current situation and understand that the regulatory landscape will change drastically.

2. Understand that concerning equity, banking, and insurance, current domestic regulatory policy is disproportionately influenced by European decisions.

3. Retaking control of the narrative is critical, but it absolutely cannot rely on qualitative commentary, much less emotionally-charged rhetoric

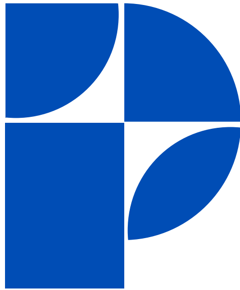
4. No matter how enticing it is to participate in the culture wars, winning the data war is far more important

5.. Proactively prepare by utilizing PEP's Simple ESG reporting platform to monitor, track and pre-emptively assess how the external divestment crowd is evaluating your company

Objective data empirically proves that global energy demand will overwhelmingly rely on fossil fuels for the foreseeable future[47]. Just as the hydrocarbon industries must provisionally accept that they currently do not control the narrative, the anti-fossil fuel crowd will painstakingly learn over the (very) long run that fossil fuel divestment is irrational, empirically unfounded, and egregiously misguided. A critical difference, however, is that fossil fuel investment is founded in economic logic, whereas the general basis for fossil fuel divestment is emotional conviction. In other words, facts can sway reason but struggle to overcome emotional beliefs. Given that dynamic, the resulting "compromise" most likely to emerge within the capital markets is to seek out the bottom quartile performers. Another unfortunate wrinkle is the lack of quality data existing within the marketplace. This implies that the onus falls directly on the corporates to provide the market with data that reflects economic reality.

We, therefore, recommend that energy companies understand and accept how the external world will evaluate them. This should not be viewed as losing or giving in – quite the contrary. Instead, it is critical to understand how an antagonist will inevitably criticize to pre-emptively counter and get ahead of potential controversy. More importantly, tracking ESG data will dictate overall eligibility for capital and the quality of coverage a hydrocarbon business can access in the insurance markets. Precedent implies that no matter how egregious or inefficient regulation may seem, odds are it remains perpetually in place once it is embedded into the regulatory bloodstream. Oil, gas, and coal have two options – act now and arm your company with the quantitative firepower required to counter influential divestment agendas and poor regulatory policy, or fall (and probably remain) within the crosshairs of the divestment whirlwind.

[42] https://www.budget.senate.gov/chairman/newsroom/press/budget-committee-launches-investigation-into-major-insurance-companies-climate-risk-evaluation-fossil-fuel-support-
[43] https://www.commondreams.org/news/fossil-fuel-finance-iccr
[44] https://www.asyousow.org/resolutions/2021/12/7-chubb-climate-disclosures-or-other-measures-to-reduce-ghg-emissions-including-setting-net-zero-targets
[45] https://s201.q4cdn.com/471466897/files/doc_downloads/annualmeetingmat/2022-AGM-Voting-Results.pdf
[46] https://www.npr.org/2023/04/09/1168446621/businesses-face-more-and-more-pressure-from-investors-to-act-on-climate-change
[47] How the U.S. Energy Space Retakes Their Global Best-in-Class Narrative



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