CALVERT INSIGHTS | RESPONSIBLE INVESTING

Proposed EPA Standards Illustrate Importance of Negative Externalities for Investors

By: Emily Wagner | July 10, 2023

Washington - On April 6, the U.S. Environmental Protection Agency (EPA) proposed strengthened standards designed to reduce cancer risks related to emissions from chemical and polymers plants. The proposal targets the reduction of air toxins, including ethylene oxide, chloroprene, benzene 1,2-butadiene, ethylene dichloride, vinyl chloride and smog-forming VOCs (volatile organic compounds). According to EPA estimates, this would reduce toxic pollution by over 6,000 tons/year and VOCs by over 23,000 tons/year.[1]

The EPA identified over 200 facilities responsible for generating, storing or emitting these toxins. Its proposed new standards would require companies to monitor and reduce levels of these air pollutants, resulting in an estimated $501 million cumulative capital cost with $190 million per year in total annualized costs.[2] Another effect would be to limit air pollution in high risk areas like Cancer Ally in Louisiana, which speaks to the EPA's efforts around environmental justice.

This proposal illustrates the importance of accurately assessing the long-term business risks of negative externalities. While short-term financial results may not be impacted by pollution or GHG emissions, over the long term, companies ultimately pay a price for the problems they cause — through regulation, taxes, lawsuits, reputational damage and more. When these externalities are later priced by governments or through market action, these serve to raise cost and influence corporate and consumer behavior.

How Calvert's Principles reduce exposure to affected plants

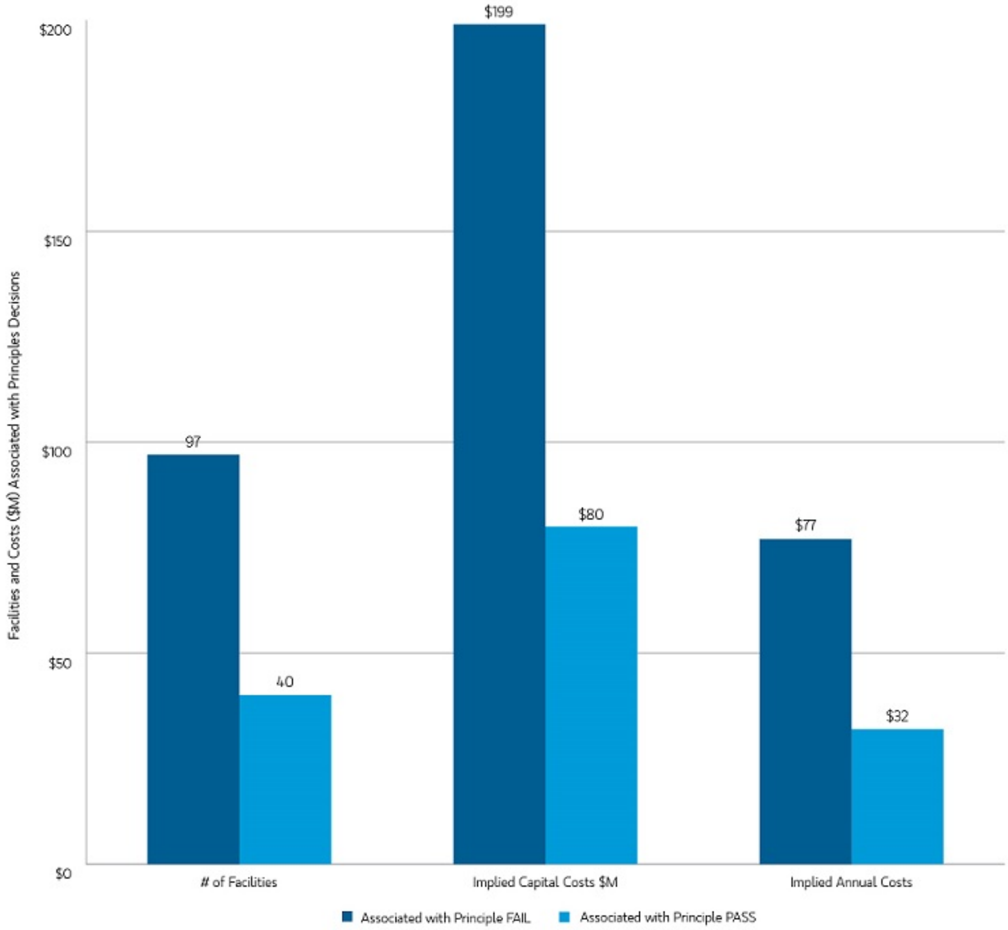
As part of our research process and application of the Calvert Principles, we account for toxic emissions via our Pollution and Waste custom indicator. Starting with the list of facilities identified by the EPA, we found 137 facilities that were associated with companies we evaluated for potential investment, which span across different GICS sub-sectors including chemicals, oil & gas, industrials and auto parts.

Our approach limits potential exposure to this proposed change in regulatory standards in the following ways:

1. Only 40 facilities are associated with eligible issuers, versus 97 facilities associated with ineligible issuers.
2. We calculated the implied capital costs to be $280 million for companies with principles decisions, of which eligible issuers represent just $80 million of that total, or 29%.
3. For the implied annual costs to facilities, we calculated the implied cumulative costs for facilities associated with principles decisions to be $109 million per year, of which only $32 million (29%) is associated with eligible decisions.[3]

In total, Calvert owns 18 issuers with a combined exposure to 34 facilities that would be impacted by the EPA's proposal. Given the clear connection between the proposed standards and pricing this known externality (pollution), we ask that these companies support the strengthened emissions standards proposed by the EPA.

Facilities and Costs Related to Chemical and Polymers Plant Emissions Associated With Calvert Principles Decisions



Source: Calvert Research & Management, EPA as of April 2023

Bottom line: Long-term responsible investors should take note of these changes, as governments have signaled that they are no longer sitting on the sidelines. They are ready to step in and legislate where corporations are unable to self-regulate.

1. EPA news release, "Biden-Harris Administration Proposes to Strengthen Standards for Chemical and Polymers Pants, Dramatically Reduce Cancer Risks from Air Toxics," April 6, 2023.

2. Federal Register, "New Source Performance Standards for the Synthetic Organic Chemical Manufacturing Industry and National Emission Standards for Hazardous Air Pollutants for the Synthetic Organic Chemical Manufacturing Industry and Group I & II Polymers and Resins Industry," April 25, 2023.

3. Analysis assumes that cumulative EPA cost estimates are shared equally by each facility. This does not account for plant size/capacity. We estimate that larger capacity facilities may be associated with large-cap issuers with principles Ineligible decisions, therefore the costs to the Ineligible category may be understated in our analysis.

Risk Considerations: *The value of investments may increase or decrease in response to economic, and financial events (whether real, expected or perceived) in the U.S. and global markets. The value of equity securities is sensitive to stock market volatility. Diversification does not eliminate the risk of loss. Smaller companies are generally subject to greater price fluctuations, limited liquidity, higher transaction costs and higher investment risk than larger, more established companies. Investing primarily in responsible investments or* ***Environmental, Social and Governance (ESG)*** *strategies carries the risk that, under certain market conditions, the Fund may underperform funds that do not utilize a responsible investment strategy. Funds are exposed to liquidity risk when trading volume, lack of a market maker or trading partner, large position size, market conditions, or legal restrictions impair its ability to sell particular investments or to sell them at advantageous market prices. No fund is a complete investment program and you may lose money investing in a fund.*

Emily Wagner
Senior ESG Research Analyst
Calvert Research and Management

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