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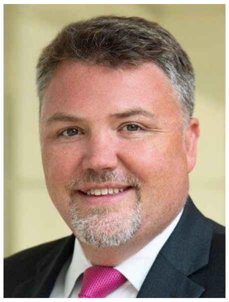
For The Future Of ESG, Look To State Bill Trends

By **Lance Dial and Rachel Mann** (January 23, 2023, 4:08 PM EST)



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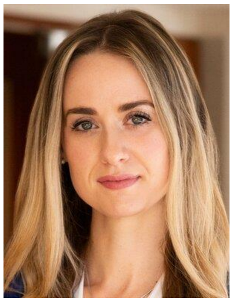

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Environmental, social and governance investing continues to be a hot-button issue as state legislatures prepare for their next legislative session.

The majority of U.S. state legislative assemblies allow bills to be prefiled, or introduced before a new legislative session begins. State politicians often use the prefiling process to demonstrate their top priorities ahead of a session.

Examining trends in prefiled bills can help identify which way the political winds will blow in an upcoming legislative session.

Below, we examine state-level legislation prefiled for the 2023 legislative sessions and identify three key trends where we expect to see state-level legislative action on ESG investing.

Key Trends for 2023

1. ESG investing remains a hot issue.

Legislators in five states used their prefiling process to get ESG bills to the top of the legislative agenda.

Four states' prefiled bills focus on limiting the use of ESG investing. These include:

- Arkansas H.B. 1049;[1]
- Missouri S.B. 177,[2] S.B. 316,[3] S.B. 50[4] and S.B. 200;[5]
- Oklahoma S.B. 15;[6] and
- South Carolina S.B. 111.[7]

In Texas, state legislators proposed three anti-ESG bills — H.B. 982,[8] H.B. 709[9] and H.B. 645[10] — and one pro-ESG investing bill, H.B. 1091.[11]

Texas' mix of proposed ESG investing legislation highlights the polarization of this issue. While three of the proposed Texas bills seek to limit the use of ESG, H.B. 1091 would repeal S.B. 13,[12] one of the country's first anti-ESG investing bills, which was enacted in 2021 as Texas Government Code, Chapter 809.

2. A new model bill on the horizon targets ESG scores.

Three state legislatures — Arkansas,[13] Missouri[14] and Texas[15] — saw prefiled bills that seek to limit corporations from discriminating based on ESG scores. This is a relatively new type of ESG investing bill.

The 2021-2022 legislative session saw many almost-identical proposed anti-ESG investing bills — and some adopted ones — that followed two models.[16]

The first type can be classified as boycott bills, which direct state entities to divest from and refuse to contract with companies that boycotted certain industries, such as fossil fuels or firearms. The second type can be classified as no-ESG investment bills, which prohibit the use of state funds for ESG or social investment.

The prefiled bills indicate that a third type of anti-ESG investment regulation may be trending in the 2023 legislative session: bills prohibiting ESG discriminations.

These bills prohibit public entities from discriminating against individuals or other companies based on ESG scores or other value-based scores. This category would generally prohibit government entities from awarding contracts based on positive — or potentially negative — evaluations of ESG criteria.

Arkansas legislators prefiled one bill, H.B. 1049,[17] prohibiting ESG discriminations, whereas Texas and Missouri legislators each prefiled three different iterations of this kind of bill. Texas' versions are H.B. 982,[18] H.B. 709[19] and H.B. 645.[20] Missouri's versions are S.B. 316,[21] S.B. 177[22] and S.B. 50.[23]

This type of proposed regulation is not brand new, although it had been an outlier in the 2021-2022 legislative session.

Missouri lawmakers proposed this type of bill back in February 2022 with S.B. 1171,[24] although it never received enough votes to make it out of the Senate committee. Notably, Missouri's three prefiled bills for this year are all substantially similar to this previous one. Pennsylvania also saw this type of bill last year with H.B. 2799 in September 2022.[25]

In the 2023 sessions, with four states proposing prohibitions on ESG discrimination, we expect to see other states following suit and considering these types of bills in the next legislative session.

3. If at first you don't succeed …

While some states are proposing new forms of ESG investing bills, some states are trying again with legislation that failed in the prior legislative session.

Members of the Missouri and Oklahoma state legislatures prefiled anti-ESG bills that are identical to proposed bills from earlier legislative sessions that failed to receive enough votes to be enacted into law. Missouri's prefiled S.B. 177[26] is identical to the failed S.B. 1171[27] from the 2022 legislative session, and Oklahoma's prefiled S.B. 15[28] is similar to its H.B. 3144,[29] which died in the 2022 legislative session.

This trend indicates the importance of keeping in mind unsuccessful anti-ESG legislation from the 2022 session that may be revived. Although some states may have failed to enact those proposed bills into law in 2022, they may seek a second shot in the next legislative session.

Also noteworthy is the fact that many states that failed to enact anti-ESG legislation in 2022 resorted to other methods of anti-ESG regulation.

For example, Arizona's boycott bill, H.B. 2473,[30] died in the Arizona House of Representatives in the spring of 2022, but the Arizona state treasurer issued a statewide binding investment policy statement[31] in August 2022 that prohibits consideration of ESG factors in investment decision making, in effect working around the failure to enact the boycott bill into law.

Similarly, Indiana's state legislature failed to pass its boycott bill, H.B. 1224,[32] in the spring of 2022, but the Indiana attorney general issued an advisory opinion[33] in September 2022 prohibiting the consideration of ESG factors in state investment decisions.

This trend also demonstrates the importance of keeping an eye on the states that have yet to pass anti-ESG legislation and noting that they may try again or find another method to institute anti-ESG regulations in the new year.

Key Takeaways

The ESG investing space continues to be rife for regulatory change in 2023 and may affect a huge swath of the corporate market. Some of the ESG regulations, such as Wyoming's enacted H.B. 0236,[34] explicitly target financial services companies only.

However, many regulations, including the newest type of bills prohibiting ESG discriminations, attempt to limit how much any business operating within the state focuses on ESG factors. Pennsylvania's proposed H.B. 2799[35] serves as an example.

Notably, state-level ESG regulations with divestment provisions only apply to state funds and public retirement plans; federal law preempts states from regulating private retirement plans.[36]

These new and proposed regulations tend to focus on investments made for ethical ESG purposes, such as divesting from oil and gas companies in order to respond to climate change concerns. They often have implicit or explicit exceptions for considering ESG factors for financial purposes such as avoiding an investment in an issuer on the basis of potential regulatory risks associated with pollution.

In reviewing these new developments, investment managers and fiduciaries should carefully consider the role ESG considerations play in their investment programs and ensure that their ESG processes are clearly disclosed to their investors.

It's important to understand that considering ESG for ethical purposes may result in the application of some of these new and proposed regulations to the firm or its products.

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general information purposes and is not intended to be and should not be taken as legal advice.

[1] https://www.arkleg.state.ar.us/Bills/Document?type=pdf&chamber=HB&source=Bills&bill=1049&ddBienniumSession=2023%2F2023R.

[2] https://legiscan.com/MO/bill/SB177/2023.

[3] https://senate.mo.gov/23info/BTS_Web/Bill.aspx?SessionType=R&BillID=44680.

[4] https://senate.mo.gov/23info/BTS_Web/Bill.aspx?SessionType=R&BillID=44408.

[5] https://senate.mo.gov/23info/BTS_Web/Bill.aspx?SessionType=R&BillID=44639.

[6] http://webserver1.lsb.state.ok.us/cf_pdf/2023-24%20INT/SB/SB15%20INT.PDF.

[7] https://www.scstatehouse.gov/sess125_2023-2024/bills/111.htm.

[8] https://capitol.texas.gov/tlodocs/88R/billtext/html/HB00982I.htm.

[9] https://capitol.texas.gov/tlodocs/88R/billtext/pdf/HB00709I.pdf#navpanes=0.

[10] https://legiscan.com/TX/text/HB645/2023.

[11] https://capitol.texas.gov/tlodocs/88R/billtext/html/HB01091I.htm.

[12] https://capitol.texas.gov/tlodocs/87R/billtext/pdf/SB00013I.pdf.

[13] https://www.arkleg.state.ar.us/Bills/Document?type=pdf&chamber=HB&source=Bills&bill=1049&ddBienniumSession=2023%2F2023R.

[14] https://legiscan.com/MO/bill/SB177/2023.

[15] https://legiscan.com/TX/text/HB645/2023.

[16] We analyzed those types of anti-ESG regulations in this Morgan Lewis ML BeneBits blog post: https://www.morganlewis.com/blogs/mlbenebits/2022/08/the-state-of-anti-esg-state-legislation.

And at length in this article: https://www.hflawreport.com/19472661/money-or-ethics-the-esg-investing-debate.thtml.

[17] https://www.arkleg.state.ar.us/Bills/Document?type=pdf&chamber=HB&source=Bills&bill=1049&ddBienniumSession=2023%2F2023R.

[18] https://capitol.texas.gov/tlodocs/88R/billtext/html/HB00982I.htm.

[19] https://capitol.texas.gov/tlodocs/88R/billtext/pdf/HB00709I.pdf#navpanes=0.

[20] https://legiscan.com/TX/text/HB645/2023.

[21] https://senate.mo.gov/23info/BTS_Web/Bill.aspx?SessionType=R&BillID=44680.

[22] https://legiscan.com/MO/bill/SB177/2023.

[23] https://senate.mo.gov/23info/BTS_Web/Bill.aspx?SessionType=R&BillID=44408.

[24] https://www.senate.mo.gov/22info/pdf-bill/intro/SB1171.pdf.

[25] https://www.legis.state.pa.us/CFDOCS/Legis/PN/Public/btCheck.cfm?txtType=PDF&sessYr=2021&sessInd=0&billBody=H&billTyp=B&billNbr=2799&pn=3437.

[26] https://legiscan.com/MO/supplement/SB177/id/289286.

[27] https://legiscan.com/MO/supplement/SB1171/id/260599.

[28] http://webserver1.lsb.state.ok.us/cf_pdf/2023-24%20INT/SB/SB15%20INT.PDF.

[29] http://webserver1.lsb.state.ok.us/cf_pdf/2021-22%20COMMITTEE%20SUBS/HCCS/HB3144%20CCS.PDF.

[30] https://www.azleg.gov/legtext/55leg/2R/bills/HB2473H.pdf.

[31] https://www.aztreasury.gov/_files/ugd/88330d_964dec07d6804fdcafb722658c4d8bff.pdf.

[32] http://iga.in.gov/legislative/2022/bills/house/1224#document-58e06d51.

[33] https://content.govdelivery.com/attachments/INAG/2022/09/01/file_attachments/2259125/Official%20Opinion%202022-3.pdf.

[34] https://wyoleg.gov/2021/Enroll/HB0236.pdf.

[35] https://www.legis.state.pa.us/CFDOCS/Legis/PN/Public/btCheck.cfm?txtType=PDF&sessYr=2021&sessInd=0&billBody=H&billTyp=B&billNbr=2799&pn=3437.

[36] We discuss this at more length in this article: https://www.morganlewis.com/-/media/files/publication/outside-publication/article/2022/anti-esg-bills-raise-questions-for-public-retirement-plans-law360.pdf.