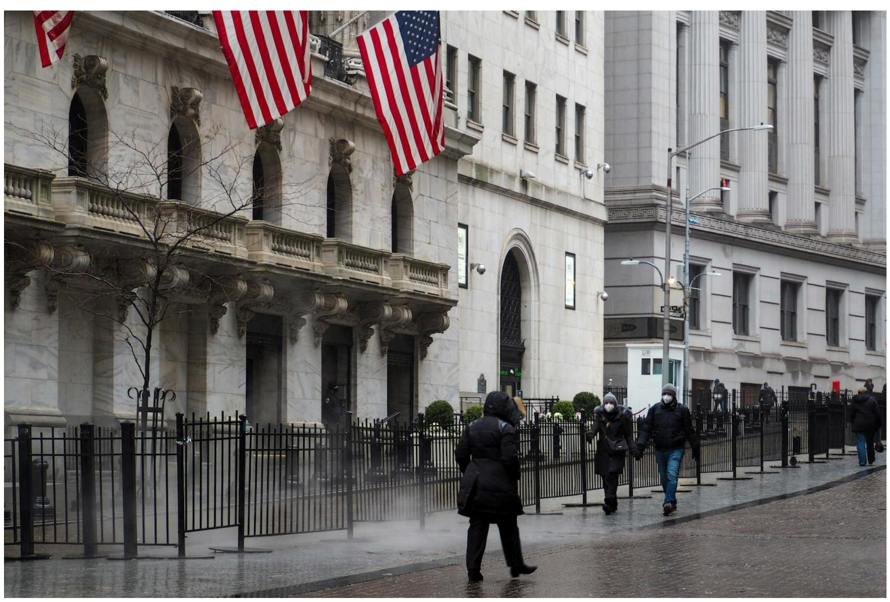
ESG: Illegal Collusion or Just Good Business Sense?

Some U.S. legislators moved to restrict companies from measuring and managing environmental, social and governance (ESG) risk, but research shows these policies are unpopular with voters and harming financial returns.

JUL 31, 2024 By Mary Mazzoni



American flags fly over the New York Stock Exchange. (Image: [David Jones]/Unsplash)

Last summer, the Judiciary Committee in the U.S. House of Representatives started investigating 14 investor violations and illegal collusion, but it wasn't looking into monopolistic mergers or predatory pricing schemes. It was focused on how the firms measured and managed climate risk.

Letters sent in 2023 warned the organizations they were "potentially violating U.S. antitrust law by entering into agreements to 'decarbonize' [their] assets under management and reduce emissions to net zero."

"The House Judiciary Committee was essentially investigating the entire global economy, saying that shareholders are not allowed to talk about risk," said Andrew Behar, CEO of the shareholder organization As You Sow, which was among those named in the investigation.

In the months since, the committee collected over 2 million pages of documents from asset mangers like BlackRock, State Street and Vanguard, along with the California Public Employees' Retirement System (CalPERS), the proxy advisor Glass Lewis and the investor group GFANZ (the Glasgow Financial Alliance for Net Zero), which includes 675 of the world's largest banks. Executives sat for hours of voluntary testimony, as committee members grilled them on whether companies are "collectively adopting and imposing left-wing environmental, social, and governance (ESG)-related goals" to the detriment of shareholders and the economy.

The committee's report from the investigation was released earlier this summer and barely made the news cycle, likely because it did not include any evidence of illegal activity. "There is no theory of antitrust law that prevents private investors from working together to capture the risks associated with climate change," Rep. Jerrold Nadler (N.Y.) wrote in a report issued by House Democrats in response. No antitrust suits were filed against any of the organizations.

said. The committee sent out another round of letters to more than 130 organizations including asset managers and universities this week, asking them for information about their involvement with Climate Action 100+, an investor group focused on climate risk.

Why does climate risk matter to investors?

Global climate scientists warn that the frequency and intensity of severe weather events will increase as global temperatures surpass 1.5 degrees Celsius above pre-industrial levels. With temperatures nearing the crucial tipping point, farming communities, shoppers and the global commodities market are already feeling the effects.

The prices of cocoa and coffee surged this year as severe rainfall and heat waves struck key growing regions in West Africa. Olive oil prices are at an all-time high as producers like Spain face their third growing season of devastating droughts. Global prices for other key commodities including soybeans and cotton also spiked over recent years as extreme weather devastated farming communities.

Human and environmental costs aside, all of this means any company that depends on raw materials needs to plan for how it will get them as supply chains are disrupted due to climate change. And asset managers need to asses the level of risk to their portfolios and make decisions accordingly in order to protect their investors' money.

"ESG is just a framework for assessing risk," said Behar of As You Sow. "If you're an investor that doesn't assess risk, you're not going to last very long. If you're a business person that doesn't assess risk, you're not going to be in business. The idea that we shouldn't assess and address

Restricting ESG risk assessment comes at a cost to investors and retirees

The House investigation is far from the only legislative attempt to restrict financial companies from assessing how climate change and corporate social policies impact their investments. "At the state level, over 300 bills were put forth across Republican states trying to make sustainable investing illegal — literally it would be illegal to assess or address risk in your portfolio, and they passed in many states," Behar said.

At least 18 states now have so-called "anti-ESG" laws that restrict state agencies and public pension funds from using ESG factors in their investments or ban state and local entities from doing business with specific financial companies.

But limiting investors' ability to assess risk and reducing competition for financial services proved detrimental to investor returns in these states. A recent report from the Texas Association of Business, which includes the oil giants ExxonMobil, Chevron and ConocoPhillips, found the anti-ESG law that bans top financial firms cost the state nearly $669 million and more than 3,000 jobs in two years.

"An analysis of the pension funds in the 18 states that have passed anti-ESG laws shows all of them are underperforming the other 32. Why? Because they can't assess and address risks," Behar said. "The people who are paying the price for this are the constituents: the firefighters, the police officers, the teachers."

Advocates and the public aren't sold on anti-ESG policies: Will it show at the polls?

from the Harvard Law School Forum on Corporate Governance.

Meanwhile a group of self-described “center-right taxpayer advocacy leaders” penned an open letter this spring discouraging state governments from intervening with investment decisions. “These politically motivated actions, driven by extreme positions in both parties, carry outsized ramifications for taxpayers, families, and businesses in a time of intense change and grave economic uncertainty,” the letter reads.

The negative impact these policies could grow more pronounced if commodity prices become more unstable. "The prices of everything are going up because of climate change," Behar said. "The companies who are not assessing and addressing risk, or are based in a state where it's illegal to assess and address risk, are at a massive disadvantage. When someone says ‘don't look at risk,’ you want to look at risk. When they make it illegal, then you really want to make sure you are looking at it strongly."

Voters have a chance to make their stance on the matter known in legislative and presidential elections in November. "The idea that any of these people who pass these laws would get reelected is beyond me," Behar said. "I don't see how anyone would vote for a public servant who just throws away their tax money, doesn't build the infrastructure that the citizens need and would lose money in their pension fund."

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