Simpson Thacher

ESG Battlegrounds:

How the States Are Shaping the Regulatory Landscape in the U.S.

March 2023

When it comes to ESG in the United States, among the most dramatic developments is an ideological battle unfolding at the state level, pitting liberal-leaning state governments that have embraced ESG-focused investing against conservative-led states that would seek to exclude it.

To date, the general consensus had been that the U.S. is lagging on its ESG focus, particularly in contrast to the EU and U.K. where investor, political and societal support has generally been strong. U.S. federal agencies have been slower to propose rules in this area than their European counterparts. As a result, much of the activity on the ESG front remains the subject of private ordering, where companies are offering disclosure and making commitments in response to investor and stakeholder demands rather than regulatory requirements.

But over the past year, the picture has shifted. States have stepped up their lawmaking, defining the future of the ESG-related regulatory environment with widely divergent approaches.

These measures focus primarily on the investment of state-level public retirement system assets. New varietals of these and other ESG-focused laws[1] are becoming regular events. Individually and collectively, the developments are further fracturing an already complicated landscape for financial services companies, including private investment managers that invest money on behalf of state pensions. Meanwhile multistate initiatives are taking aim at individual asset managers, banks and proxy advisory services perceived to be driving ESG growth.[2] In at least one state,

1 For example, lawmakers in Iowa and Minnesota have introduced bills that would propose exceptions to child labor regulations in those states. Hawaii has introduced a bill relating to corporate board diversity requirements. Minnesota recently signed a bill into law that applies a standard to utilities to supply customers with electricity generated or procured from carbon-free sources. Alaska's Governor recently announced a bill package to introduce the state to the emerging carbon markets, under which the state's Department of Natural Resources would be authorized to promote and provide geologic and biologic sequestration. Several state bills would seek to prohibit state or local investments in companies that do business with or in certain foreign countries, or in businesses owned or operating by certain foreign governments or non-governmental organizations.

2 Several State AGs and State Treasurers have announced the divestment or planned divestment from major asset managers on the basis of ESG investment practices, though in at least one case a "truce" will reportedly allow the asset manager to continue overseeing pension assets. As of October 2022, at least 19 states had launched investigations into the ESG investing practices of several large banks and their role in certain membership organizations (*e.g.*, the industry-driven United Nations Net-Zero Banking Alliance). In January 2023, 21 state AGs signed a letter to two prominent proxy advisory services, ISS and Glass Lewis, stating that the firms had "potentially violated their legal and contractual duties as proxy advisers, with respect to advocating for and acting in alignment with climate change goals," and seeking responses to questions concerning how ESG considerations affect their proxy voting recommendations.

banks are fighting back.[3]

Much attention has focused on so-called "anti-ESG measures"—those prohibiting the consideration of ESG factors when investing state retirement funds or targeting companies that "boycott" industries such as fossil fuel or firearms companies—and the organizations behind them.[4] A smaller but significant number of "pro-ESG" measures seek different outcomes and are gaining traction.[5] Other measures perhaps best described as "ESG-neutral" have led to or appear to be leading to pro- or anti-ESG legislative outcomes.[6]

In some states, more extreme versions of ESG-focused legislation are being scaled back or failing to progress, as a result of powerful opposition constituencies reacting to real or perceived increases to the cost of capital,[7] or to compliance-related challenges.[8] For example, Indiana HB 1008, which would require the state's public retirement system to divest from and cease doing business with companies or funds that consider ESG factors in their investing, was amended to exempt private market funds from its provisions following opposition from the Indiana Chamber of Commerce.[9] The organization has noted its opposition to the bill even as amended, and a report by the Indiana Legislative Services Agency has determined that the bill in its revised form will pose less but still significant costs to the state retirement system ($5.5 million over 10 years as opposed to $6.7 billion).[10] Two proposed anti-ESG bills in Wyoming, one restricting state funds from considering nonfinancial purposes in making investments, and the other an anti-boycott bill, were voted down due to concerns about how broadly and subjectively they defined the term "ESG."[11]

3 Following passage of Kentucky SB 205, which targets banks that engage in deemed energy company boycotts, Kentucky's state attorney general issued subpoenas and civil investigative demands to various banks and announced plans to investigate their involvement with the Net-Zero Banking Alliance. The Kentucky Bankers Association has sued the attorney general, alleging freedom of speech and freedom of association violations, among others. *See* Ron Lieber, "The E.S.G. Fight Has Come to This: Bankers Suing Lawyers; your money," *The New York Times* Feb. 24, 2023, available here.

4 Several bills and certain laws in force are reported to have been patterned on model bills drafted by the American Legislative Exchange Council (ALEC), a national policy organization known for drafting conservative model legislation with key industries and encouraging their introduction in state legislatures. *See* David J. Berger, David H. Webber and Beth M. Young, "The Liability Trap: Why the ALEC Anti-ESG Bills Create a Legal Quagmire for Fiduciaries Connected with Public Pensions," Feb. 15, 2023, available here. Notably, following a unanimous vote by ALEC's energy task force last December to adopt one of the bills (the anti-boycott bill), ALEC's board declined to approve the measure in January and sent it back to the task force for reconsideration. *See* ABA Banking Journal, "ALEC board rejects model anti-ESG bill," Jan. 23, 2023, available here. *See also* Julie Bykowicz, "Conservatives Have a New Rallying Cry: Down with ESG," *Wall Street Journal*, Feb. 27, 2023, available here (describing a new, multimillion dollar initiative led by a former Federalist Society member to drive anti-ESG legislation and communications).

5 *See, e.g.*, Tim Quinson, "More States Push Back Against GOP's Anti-ESG Campaign," *Bloomberg News*, Feb. 22, 2023, available here (predicting additional, near-term pro-ESG investing measures in the upper Midwest and Northeast).

6 For example, in June 2022 Louisiana enacted a taskforce by law to issue recommendations regarding the regulation of ESG factors in lending and investment practices, and also an ESG Criteria Study Group to issue recommendations regarding the regulation of the use of ESG factors in lending and investment practices. Four months later, the state removed $794 million in funds from a major asset manager on the basis of ESG investing strategies it employed. Massachusetts lawmakers, having already established an ESG committee to serve the state pension reserves investment management board, and having proposed various pro-ESG bills, are pursuing a bill to establish a committee to consider climate risk associated with state pension reserves investments and to assess divestment readiness.

7 At least two reports have addressed the impacts of anti-ESG measures on state municipal bond markets. *See* Daniel Garrett and Ivan Ivanov, "Gas, Guns, and Governments: Financial Costs of Anti-ESG Policies," U. Penn. May 30, 2022, available here (reporting that Texas' enactment of two laws, described below, has led five large banks that underwrote 40% of Texas' municipal debt to exit the state, which has decreased competition and increased costs for stakeholders, specifically adding $300 to 500 million to borrowing costs on debt issued in the first eight months after the laws were enacted); and "ESG Boycott Legislation in States: Municipal Bond Market Impacts," The Sunrise Project, Jan. 12, 2023, available here (leveraging the U. Penn. study and anticipating potential costs to six states that have passed or are considering similar legislation and directives as those implemented in Texas).

8 The predecessor to California's climate disclosure bill, discussed below, failed to pass the California Assembly, reportedly owing to a reporting requirement that extends well beyond the climate disclosure rule proposed by the SEC.

9 Michael Katz, "Indiana Amends ESG Bill to Exclude Private Markets," *Chief Investment Officer* (Feb. 24, 2023), available here.

10 *Ibid.*

11 Rob Kozlowski, "Wyoming House committee comes out against 2 anti-ESG bills," *Pensions & Investments* Feb. 27, 2023, available here; "Wyoming votes down anti-ESG measures in legislature," *Fintech Global* March 7, 2023, available here.

More extreme measures on both sides, anti- and pro-ESG, have prompted some observers to sound the alarm that the United States may be straying from the fundamental purpose of ESG factors—as a valuation metric to gauge corporate success.[12]

Whether, how long and to what extent the shift in ESG regulatory power remains with the states is yet to be seen. For now, in the United States, the term "ESG" is remarkable in its political divide. Below, we unpack current state-level developments focused on ESG investing and contracting.[13] We offer the following high-level takeaways:

- We expect more states to propose or adopt anti- (and pro-) ESG state laws, particularly as the 2024 U.S. presidential election approaches and political agendas solidify, and as the global ESG regulatory framework, including a growing web of EU-related ESG measures, comes into greater focus.
- The scope and nature of such measures will continue to evolve in reaction to the success or failure of similar measures, the availability of data on the financial and non-financial impact of such measures,[14] the continuing debate as to the opportunities and challenges associated with ESG (including with respect to ESG and investor returns, ESG ratings methodologies and measurement challenges, and inconsistencies in current reporting standards), voter interest,[15] organizational influence over lawmaking in state legislatures, and activities at the federal level relating to how fiduciaries can consider ESG factors in investment decisions.[16]
- The surge of anti-ESG measures poses significant legal, operational, reputational, political and financial concerns for funds, asset managers and companies that integrate ESG investment into their policies, procedures and disclosures, threatening state contracts and the removal of state funds from investment portfolios and the reinvestment of assets in the first instance. These laws include a variety of different applications and carve-outs, and whether a company is in scope will depend on varied analysis in each state. Monitoring these measures and understanding the nature of conflicting requirements and associated risk will be essential.
- As a general matter, these measures are still relatively untested, resulting in considerable uncertainty about their ultimate interpretation and implementation. In some cases, carve-outs may potentially be used to protect investments and avoid compliance violations (at least in respect of entities not yet subject to blacklisting), but should be approached with caution.

Simpson Thacher will maintain the following charts, available in two different formats, measures by type and measures by state. These charts will also be available on our ESG Practice Page.

12 *See, e.g.*, Daniel F.C. Crowley and Robert G. Eccles, "Rescuing ESG from the Culture Wars," *Harvard Business Review* Feb. 9, 2023, available here.

13 With some exceptions, we do not consider bills that have been withdrawn, died on calendar or otherwise been defeated, though note that a significant number of both pro- and anti-ESG bills have met this fate and provide context for the measures currently under consideration.

14 *See* n. 7.

15 *See, e.g.*, Debra Kahn and Jordan Wolman, "Cracks in the anti-ESG foundation," *Politico*, Jan. 24, 2023, available here (reporting that two-thirds of major clean energy projects announced as a result of the Biden Administration's signature climate change law, the Inflation Reduction Act, are anticipated to be located in Republican-held congressional districts).

16 Half of U.S. states have sued to block the U.S. Department of Labor's (DOL) new rulemaking applicable to ERISA plans related to ESG factors, which we described here. That rulemaking provides that an ERISA fiduciary's consideration of ESG factors may, under certain circumstances, be consistent with ERISA's stringent fiduciary duties. On March 1, the U.S. Senate voted to overturn the rule, which resolution President Biden has promised to veto if it comes to his desk.

1. State Measures Restricting the Consideration of ESG Factors in State Investment Strategies

As of March 9, 2023, and as set out in the table below, at least seven states have enacted laws or adopted regulatory action in the form of policy statements or directives that seek to prohibit or discourage public entities from considering ESG factors when investing state resources. These measures prohibit the consideration of "non-pecuniary" factors by public pension funds as being inconsistent with the exercise of fiduciary duties. The measures define this concept differently but ultimately capture the use of factors other than those that seek specifically to maximize investment returns.

Some measures (such as Idaho SB 1405 and North Dakota SB 2291) contain important exceptions that would allow state pension fund managers to incorporate ESG factors into investment decisions in certain circumstances. Whether these carve-outs are motivated by a desire to protect against economic losses, or a recognition of ESG's relevance to many investors, is unclear.

Meanwhile, lawmakers in at least 13 states have introduced bills since the beginning of 2023 that are progressing through the legislative process at different speeds,[17] or have announced plans to do so,[18] which are in some cases broader or more prescriptive than initiatives currently in force. The prohibitions generally apply to state pension fiduciaries, proxy advisors and service providers. They essentially prohibit in-scope entities from considering a company's long-term sustainable growth plan in evaluating or managing an investment or, depending on the investment, when taking a more proactive approach (proxy voting). Some measures attach significant penalties for noncompliance.[19]

Here again, certain measures contain exceptions that would theoretically permit in-scope companies to comply with the laws while continuing to safeguard investments made on the basis of investing strategies that incorporate ESG factors. However, the definitions and provisions that the carve-outs employ are ambiguous and open to uncertain interpretation.[20] As a result, entities seeking to leverage potential exceptions are likely to encounter difficulties in determining what their precise legal obligations are.

17 *See* Arizona SB 1500; Arkansas HB 1253; Indiana HB 1008; Indiana SB 292; Missouri SB 436; Missouri HB 824; Missouri HB 769; Montana HB 228; Nebraska LB 743; New Hampshire HB 457; Ohio S B6; Oklahoma HB 1617 / HB 2545 / HB 2777; South Carolina HB 3690; South Carolina HB 3565; Texas SB 1446; Utah SB 96; and West Virginia HB 2862.

18 Idaho legislators have described a proposed bill as focused on contracts and access to financial services. *See* Clark Corbin, "Idaho legislators readying bill to restrict environmental and social ratings in investments," *Idaho Capital Sun* (11/22/22), available here. Kansas' attorney general has described an anti-ESG push as his chief policy priority. *See* Andrew Bahl, "As conservatives push to combat 'woke' investing by KPERS, Kansas joins national trend," *Topeka Capital-Journal* (Feb. 5, 2023), available here.

19 *See, e.g.*, **Missouri** SB 436 (providing that a participant of a system or their beneficiary may bring an action for damages or injunctive relief against any person that has engaged in, is engaging in, or is about to engage in a violation, and that in addition to other remedies available, a company that serves as an investment fiduciary and violates the provisions will be required to pay damages to the state in an amount equal to three times all moneys paid to the company by the system for the company's services).

20 For example, several bills introduce a distinction between pecuniary and nonpecuniary factors but acknowledge circumstances in which nonpecuniary factors may be pecuniary, and as such, would be evaluated in the context of a public investment or in exercising rights relating to the investment. However, the definitions of pecuniary and nonpecuniary are vague, over-broad and not mutually exclusive, such that entities will likely struggle to reasonably anticipate what their obligations are and/or could result in a situation where a factor could be both pecuniary and non-pecuniary simultaneously. Certain bills that impose enhanced obligations on fiduciaries who have concluded that ESG factors are pecuniary outline requirements that are vague and unclear (*e.g.*, requiring them to examine the level of diversification, degree of liquidity and potential risk-return as compared to available alternative investments, but without delimiting the population of alternative investments to evaluate).

Measure	Description	Exceptions / Notes
Laws		
Idaho SB 1405, in effect 7/1/22	Prohibits public entities including state investment boards from considering ESG characteristics in investment decisions in a manner that could override the prudent investor rule	ESG-preferred investments may be offered, provided that they are optional and sufficient alternatives are also offered
North Dakota SB 2291, in effect 3/24/21	Prohibits investment of state funds for the purpose of "social investment"[21]	Does not apply where the state investment board can demonstrate that a social investment has an equivalent or superior rate of return as compared to a similar non-social investment with a similar time horizon and risk

21 Defined as consideration of socially responsible criteria in the investment or commitment of public funds for the purpose of obtaining an effect other than a maximized return to the state.

Measure	Description	Exceptions / Notes
Policies / Statements		
Arizona, State Treasurer's Office investment policy statement, adopted 8/30/22	Prohibits consideration of non-pecuniary factors when evaluating state investments or discharging duties with respect to same (including voting) Prohibits lending securities to any borrower with a practice of or a commitment to engaging with companies or voting shares based on non-pecuniary factors	On 2/13/23, Arizona's Attorney General announced that the state would end investigations into investment firms pursuing ESG investing, which were initiated under the state's previous attorney general; it is unclear how and to what extent the statement affects implementation of the revised investment policy
Florida State Board of Administration revised investment policy, in effect 8/23/22	Requires the state board to evaluate investment decisions for the retirement system based only on pecuniary factors	
Florida CFO Directive 1/23/23	Prohibits asset managers from investing income of participants in Florida's deferred compensation program in financial products associated with ESG standards	
Indiana Attorney General Opinion, 9/1/22	Establishes that ESG investing in the context of the Indiana public retirement system is a violation of fiduciary duties	
Kentucky Attorney General Opinion, 5/26/22	Establishes that stakeholder capitalism and ESG investment practices are inconsistent with state law governing fiduciary duties owed by investment management firms to state public pension plans	
Mississippi Treasurer letter to Public Employees' Retirement System Board Members, 11/14/2022	Urges the board to reject ESG policies and formally prohibit the use of nonpecuniary factors in the investment policy	

2. State Anti-boycott Bills Targeting Companies Doing Business With State Governmental Entities

As set out in the table below, at least eight states have enacted laws targeting companies doing business or seeking to do business with states on the basis of deemed "boycotts" or "discrimination" they engage in with respect to certain industries considered "disfavored" by the ESG movement. In two cases, states have established committees or commissioned studies to consider such measures.

With respect to the former, several measures (Kentucky SB 205, Oklahoma HB 2034, Texas SB 13 and West Virginia SB 262) require or authorize state regulators to develop and maintain a blacklist of financial entities that engage in boycotts of fossil fuel companies for divestment purposes. Some laws (those listed above plus Texas SB 19) compel companies entering into contracts with state entities to attest, as a condition of doing business with public entities, that they do not and will not engage in boycotts against fossil fuel companies or discrimination against firearms entities during the life of the contract (thresholds apply).

Here again, certain key terms and concepts are vaguely defined,[22] raising questions as to what actions by an in-scope entity would qualify as an economic boycott

22 Applicable measures define "economic boycott" broadly, namely as "without an ordinary purpose" either "refusing to deal with," terminating business activities with, or otherwise taking any action intended to penalize, inflict economic harm on, or limit commercial relations with a company because the company is in the fossil fuel industry, does business with such companies, or does not commit or pledge to meet environmental standards beyond applicable federal and state law. Applicable measures also define "discrimination" broadly, as "refusing to engage in the trade of any goods or services" with an entity or association, to refrain from continuing a business relationship with the entity or association, or to terminate an existing business relationship based solely on its status as a specific type of entity or trade association. As referenced above, following Kentucky's enactment of a law that requires the State Treasurer to maintain a list of financial firms that have engaged in energy company boycotts, the state AG launched an investigation of national banks "for alleged antitrust and consumer protection law violations related to ESG investment practices," focusing chiefly on their involvement with the United Nations' Net-Zero Banking Alliance.

or discrimination (*e.g.*, capital allocation or proxy voting pursuant to a client-defined strategy that seeks discrete sustainability-related outcomes with respect to targeted industries, to avoid violating fiduciary duties). As referenced above, following Kentucky's enactment of a law that requires the State Treasurer to maintain a list of financial firms that have engaged in energy company boycotts, the state AG launched an investigation of national banks "for alleged antitrust and consumer protection law violations related to ESG investment practices," focusing chiefly on their involvement with the United Nations' Net-Zero Banking Alliance.

Certain measures contain narrow exceptions that would theoretically allow companies to comply with the laws while continuing to protect their investments. For example, some requirements establish that a public entity may be able to avoid divestment where it determines that divestment would be at odds with its fiduciary responsibilities, and other requirements establish that financial entities may refuse to deal with fossil fuel companies provided that the decision is based on an "ordinary purpose" (undefined but presumably one that is economically motivated).

Meanwhile lawmakers in at least nine states have introduced bills since the beginning of 2023 (with one bill carried over from the 2022 legislative session) that are progressing through the legislative process at different speeds. If passed in their present form, these measures are in some cases broader or more prescriptive than initiatives currently in force. Some attach significant penalties for noncompliance.[23] These bills take various forms but broadly speaking capture measures that would:

- Require or authorize states to divest from financial institutions engaged in economic boycotts or discrimination against fossil fuel or firearms industries, or prohibit contracts with companies that discriminate against same, absent written verifications (these measures resemble the ones currently in force);[24]
- Require or authorize states to divest from financial institutions that discriminate against a broader set of industries and/or on the basis of ESG factors; prohibit contracts with companies that engage in economic boycotts against a broader set of industries and/or entities, or companies that use ESG criteria; or otherwise prohibit the state from considering ESG factors in state procurement and contracting processes[25] (these measures adopt a broader focus than ones currently in force);[26]
- Prohibit financial institutions or companies from discriminating against persons or entities based on ESG criteria or scores, and require disclosure from financial institutions that offer customers investments, products and services that employ ESG standards[27] (these measures also adopt a broader focus than ones currently in force).

23 *See, e.g.*, **West Virginia** SB 182 (permitting a victim of unlawful discriminatory practice to bring a civil cause of action for remedies including actual and compensatory damages, treble damages, exemplary damages, injunctive relief and "any other appropriate civil relief"); and **South Carolina** S 111 (subjecting any bank or credit union to a $50,000 fine for a first offense, and a $250,000 fine for a second offense and any subsequent offense, where five or more offenses result in the doubling of fines for all subsequent violations).

24 **Arizona** SB 1612 (would permit the cancellation of contracts with and investigations of financial institutions that have written ESG policies that include boycotting fossil fuels and bar public entities from investing public monies in or with them); **Missouri** SB 200, **Oklahoma** HB 2218 / SB 842 and **Oklahoma** SB 15 (would prohibit state contracts with companies absent written verification that the company does not and will not discriminate against firearms entities or trade associations); and **West Virginia** SB 182 (would prohibit financial institutions and governmental entities from discriminating against firearms entities or trade associations).

25 **Arizona** SB 1096 (would prohibit public entities from adopting a procurement, investment or other policy that induces or requires a person or company to discriminate against a firearms entity or trade association); **Missouri** SB 50 (would prohibit public entities from applying preferential treatment or discrimination based on ESG scores); and **Missouri** SB 316 / SB 177 (same with additional restriction applied to registered Missouri LLCs).

26 **Arizona** SB 1611 (would prohibit public entities from contracting with companies absent written verification that the company does not and will not implement an ESG standards policy for the duration of the contract, and would prohibit public entities from adopting a policy that induces or requires such a policy); **Arkansas**, SB 41 (would prohibit funds and financial services providers from discriminating against energy, fossil fuel, firearms or ammunition industries or other businesses based on ESG factors, and requiring divestment from same); **Arkansas** HB 1307 (same); **Minnesota** SF 1225 / HB 707 (would prohibit the state investment board from investing in assets that intentionally exclude enumerated, Minnesota-based companies in pursuit of an ESG grade or rating, require divestment from same, and prohibit financial institutions from refusing to provide financial services to or discriminating against persons based on their political affiliation or value-based or impact-based criteria); **Minnesota** SF 940 (would prohibit the state investment board from investing in companies engaged in boycotts of enumerated industries, require divestment from such companies, prohibit state contracts with companies absent written verifications, and prohibit financial institutions from refusing to provide financial services to, or discriminating against, persons based on ESG and other criteria, unless the ESG standards are fully disclosed and explained prior to contracting); **North Dakota** HB 1278 (would prohibit designated agents acting as custodians of securities purchased on behalf of funds managed by the state investment board from membership in an association that has not publicly supported the state's fossil fuel and agriculture industries, and compel agents offering advisory services to support such industries); **South Carolina** HB 3564 (would prohibit state contracts with companies absent written verification that the company does not use any ESG standards, and does not and will not engage in economic boycotts of companies in enumerated industries, or which do not meet certain ESG standards relating to GHG emissions disclosure or certain governance criteria, or which do not and do not plan to facilitate access to abortion, sex or gender change or transgender surgery); and **Oklahoma** HB 1947 and HB 2340 (same).

27 **Arizona** SB 1138 (would prohibit financial institutions, insurers and credit reporting agencies from discriminating against any person based on their political affiliation or ESG or values-based or impact criteria); **South Carolina** S 111 (would prohibit financial institutions from discriminating against citizens or businesses in lending decisions using ESG factors); and **Texas** HB 645 (would prohibit financial institutions and businesses from offering products or services using value-based criteria).

Our earlier observations with respect to potential compliance-related challenges are also applicable here, with other potential outcomes noted. For example, given the restrictions that some bills would apply in the procurement context (*e.g.*, prohibiting state government entities from requesting ESG information from suppliers), such measures could threaten to reverse progress related to supply chain-related transparency with respect to social and environmental issues, resulting in stakeholder harm.

Measure	Description	Exceptions / Notes
Kentucky SB 205, signed into law and in effect 4/8/22	Divestment Requires the State Treasurer to prepare and maintain a list of publicly-traded financial companies that have engaged in energy company boycotts, and state governmental entities involved in state investment, deposits or transactions above a specified threshold to divest from listed financial companies that do not cease energy company boycotts within established timeframes Contracting Prohibits state governmental entities from entering into contracts for goods or services (value at $100K or more) with a company with at least 10 FTEs absent written verification that the company does not and will not engage in energy company boycotts during the term of the contract	Divestment Exception Allows financial companies to refuse to deal with fossil fuel companies so long as that decision is based on an "ordinary business purpose" Allows a state governmental entity to cease divesting where reasonable evidence shows that it has suffered or will suffer a material financial loss, or an individual portfolio that uses a benchmark-aware strategy would be subject to aggregate expected deviation from its benchmark as a result of divestment Does not apply where the state governmental entity determines the requirements are inconsistent with the entity's fiduciary responsibility with respect to the investment of entity assets or other duties imposed by law relating to the investment of entity assets Governmental entities are not required to divest from any indirect holdings in actively or passively managed investment funds or private equity funds Contracting Does not apply where the governmental entity determines the requirements are inconsistent with the entity's constitutional, statutory or fiduciary duties relating to the issuance, incurrence or management of debt obligations or the deposit, management, borrowing or investment of funds *Notes*: An initial list of financial companies was released on 1/3/23
New Hampshire HB 1469, in effect 6/22/22	Established a committee to study the need for anti-discrimination legislation in the state's financial services industry	
North Dakota SB 2291, in effect 3/24/21	Requires a state Department of Commerce study on ESG-related investment policies, state involvement with companies that consider ESG factors in their decisions, and the implications of total divestment from companies that boycott energy or commodities	
Oklahoma HB 2034, in effect 11/1/22	Divestment Same as Kentucky law above; applies to all state retirement systems Contracting Same as Kentucky law above	Divestment Exception Essentially the same as Kentucky law above, though applies a clear and convincing as opposed to a reasonable evidence standard with respect to determining financial loss, and describes such loss as a loss in the value of assets under management as opposed to material financial loss

Measure	Description	Exceptions / Notes
Tennessee SB 2649, in effect 7/1/22	Prohibits the State Treasurer from entering into contracts or amendments with a state depository for the state's primary cash management banking services where the entity has a policy prohibiting financing to fossil fuel companies	Exceptions Does not apply where the governmental entity determines the state depository's services are necessary for it to perform its functions and/or services may not be obtained elsewhere
Texas SB 13, in effect 9/1/21	Divestment Same as Kentucky and Oklahoma laws above; applies to multiple state retirement systems and the permanent school fund Contracting Same as Kentucky and Oklahoma laws above	Divestment Exception Same as Oklahoma law above *Notes:* An initial list of financial companies was released on 8/24/22 The Texas Comptroller has sent a letter warning state pension funds and an entity that manages money for the public school systems to sever all relationships with listed companies A bill to repeal the law has been filed
Texas SB 19, in effect 9/1/21	Contracting Prohibits state governmental entities from entering into contracts for goods or services (value at $100K or more) with a company with at least 10 FTEs absent written verification that the company does not and will not discriminate against a firearms entity or trade association during the term of the contract	Exceptions Does not apply where the governmental entity contracts with a sole-source provider or does not receive bids from a company that is able to provide the required written verification Certain contracts exempted
West Virginia SB 262, in effect 6/10/22	Authorizes the State Treasurer to prepare and maintain a list of financial companies that have engaged in energy company boycotts, to exclude listed companies from the selection process for state banking contracts, to refuse to enter into banking contracts with listed companies, and to require, as a term of banking contracts, an agreement by a financial institution not to engage in energy company boycotts for the duration of the contract	*Notes:* An initial list of financial companies was released on 7/28/22
Wyoming HB 0236, in effect 7/1/21	Prohibits financial institutions from discriminating against firearms businesses or trade associations	Does not apply where a financial institution opts not to provide services to firearms businesses for business or financial reasons or pursuant to a regulation or written company policy

3. State Measures That Combine Anti-ESG Investing and Anti-boycott Components

In three states, we are tracking bills proposed since the beginning of 2023 or announcements as to future legislative initiatives that may best be described as combined or hybrid measures. Given their unique status, we describe each briefly here.

Iowa HF2 would: (i) prohibit public funds from granting proxy voting authority to persons not associated with a fund, or adopting a practice of following a proxy advisor's recommendations, or entering into agreements with investment advisors, unless those persons do not consider "improper financial factors" that further ESG goals; and (ii) prohibit public entities from entering into contracts with companies absent written verification that such companies are not engaged in and will not engage in economic boycotts of enumerated industries based on ESG criteria for the duration of the contract (certain thresholds and exceptions apply).

Oklahoma SB 974 would: (i) prohibit the use of ESG criteria or economically targeted investment (ETI) requirements; (ii) prohibit the use, promotion, enforcement, providing data for use in, or otherwise participating in the creation or use of ESG or ETI policies in employee hiring, firing and evaluation by government entities, political subdivisions, businesses or persons; (iii) prohibit consideration of ESG, ETI or related criteria in awarding state contracts; and (iv) require any company, organization or entity vying for a state contract to attest that its employees will not be subject to personal ESG, ETI or related scoring as a basis of hiring, firing and evaluation.

Additionally, Florida Governor Ron DeSantis has announced a legislative proposal that would: (i) prohibit the use of ESG in all investment decisions at the state and local level; (ii) prohibit banks that engage in corporate activism from holding government funds as a qualified public depository; (iii) prohibit state and local entities from considering, giving preference to, or requesting information about ESG as part of the procurement and contracting process; (iv) prohibit the use of ESG factors by state and local governments when issuing bonds; and (v) prohibit financial institutions from discriminating against customers on the basis of their religious, political or social beliefs.

4. State Measures Promoting the Consideration of ESG Factors in State Investment Strategies

As set out in the table below, at least two states have laws in force requiring public entities to develop ESG policies or standards that apply to state investments, particularly concerning public pension fund investment decisions. At least three states have introduced policy changes in this vein. The measures differ as to scope, with a majority focused on ESG factors broadly (all but Maryland HB 740 / SB 566) as opposed to climate risk more narrowly. Ultimately, all seek to promote the use of ESG factors in investment decisions to capture both financial and nonfinancial, impact-related outcomes that attach to such investments.

Meanwhile lawmakers in at least four states have introduced bills since the beginning of 2023 (with one carried over from the 2022 legislative session) that are progressing through the legislative process at different speeds and require or encourage the consideration of ESG factors in state investment decisions, including by means of policy development or disclosures.[28]

28 *See e.g.*, **Hawaii** HB 1506 / SB 1227 (would encourage the employees' retirement system, in evaluating venture capital investments, to consider investments in industries that will sustain Hawaii's natural environment or produce economy opportunism for its residents); **Illinois** HB 2782 (would require investment managers to comply with annual sustainability disclosure requirements for state investments); **New Jersey** AB 1865 (would require the state investment division to develop a comprehensive plan to assess and identify ESG-related risk and exposure of managed investment portfolios); **Washington** HB 1283 (would require the state investment board to publicly report analysis of climate-related financial risk, social responsibility and the establishment and use of proxy voting and corporate governance policies within private and public market portfolios, including Paris alignment).

Measure	Description	Exceptions / Notes
Laws		
Illinois, PA 101-473, in effect 1/1/20	Requires state and local government entities managing public funds to develop, publish and implement policies outlining how they consider ESG factors in relation to their overarching goal of achieving sustainable returns Requires entities to prudently integrate sustainability factors into investment decision-making, investment analysis, portfolio construction, due diligence and investment ownership	Does not apply to financial institution time deposits or processing services

Measure	Description	Exceptions / Notes
Maryland HB 740 / SB 566, in effect 6/1/22	Requires the state retirement and pension board to consider climate risks in its investment policy and associated with its investment portfolio across certain sectors and asset classes, to identify investment opportunities in certain energy sectors, to develop a process to regularly assess certain impacts of climate risk, and to report annually on climate risk levels across the portfolio Requires a fiduciary to consider the potential systemic risks of the impact of climate change on the assets of the several systems, including monitoring net-zero aligned investments and climate solutions to ensure a path to a long-term sustainable portfolio Requires the Chief Investment Officer for the system to review and manage investments of several systems based on the climate risk assessment, and to identify certain investment opportunities, to develop transition assessments in certain sectors, and to evaluate investment managers under certain circumstances	
Policies / Statements		
New Mexico Permanent Funds Environmental, Social, and Governance Policy, approved by the New Mexico State Investment Council in August 2021	Establishes guidelines for the incorporation of ESG considerations into the process applied by the state investment office and council in connection with managing investments in the New Mexico Permanent Funds	
Oregon Investment Council approval of an amendment to the state investment policy for Oregon Public Employees Retirement Fund, 9/9/20	Formally integrates ESG factors into fund management policy	
Texas Teacher Retirement System ESG policy, in effect 10/1/21	Formally incorporates ESG statement into investment policy	

5. State Measures Prohibiting Public Investment in Certain Industries

At least six states have laws in force or policy initiatives that prohibit investment in ESG-disfavored industries. All target fossil fuel producers and firearms businesses. Lawmakers in at least nine states have introduced bills since the beginning of 2023 that are progressing through the legislative process at different speeds, capturing proposals that resemble current laws[29] and those that are broader, either because they require additional actions by public entities[30] or target additional industries or activities.[31] Legislators in one state have introduced bills that would prohibit private investments in private prisons.[32]

29 **California** SB 252 (fossil fuel); **Connecticut** HB 6348 (fossil fuel); **Connecticut** HB 6397 (fossil fuel); **Hawaii** SB 423 (fossil fuel); **Illinois** HB 3037 (fossil fuel); **Massachusetts** HD 3680 (firearms); **Massachusetts** HD 2669; (fossil fuel); **Massachusetts** SD 377 / HD 2335 (firearms); **New Jersey** A 1733 / S 416 (fossil fuel); **New Jersey** A 1752 / S 1407 (firearms); **New York** S 1953 (fossil fuel); **New York** S 899 / A1101 (fossil fuel); **Oregon** HB 2601 (fossil fuel); **Vermont** S 42 (fossil fuel); and **Vermont** H 197 (fossil fuel). Note that both here and below, certain Massachusetts bills have been pre-filed or filed and not yet officially introduced.

30 *See, e.g.*, **California** SB 252 (in addition to prohibiting the state public retirement systems from making new investments or renewing existing investments in thermal coal companies, the bill would require constructive engagement with thermal coal companies on their plans to transition to clean energy generation, and would prohibit investment in fossil fuel companies by public employees and teachers retirement systems and require liquidation of such investments); **Connecticut** SB 42 (would require the State Treasurer to issue an annual report scoring companies on climate-related sustainability factors and detailing failures of companies that state pension funds are invested in to comply with state climate-related sustainability goals).

31 *See, e.g.*, **Massachusetts** SD 1234 / HD 1539 (would divest state pension funds from corporations involved in the manufacture or maintenance of nuclear weapons); **New Jersey** A 4232 / S 2701 (would prohibit investment of state pension and annuity funds in, and require divestment from, companies involved in manufacture or maintenance of nuclear weapons); **New York** S 205 (would prohibit state chartered banking institutions from investing in and providing financing to private prisons).

32 *See* **Rhode Island** H 5733 / S 168.

As a general matter, these bills adopt a comparatively more restrictive approach than the measures promoting the incorporation of ESG factors in investment described above, as they prohibit state agencies and public funds from holding stakes in specific industries.

Measure	Description	Exceptions / Notes
Laws		
Maine HP 65 / LD 99, in effect 6/16/21	Requires the public employees retirement system to divest from the fossil fuel industry by a specified date, and specifically identifies the 200 largest public fossil fuel companies as determined by carbon in their reserves Requires the state, including the pension fund and state treasury, to divest itself of assets invested in the fossil fuel industry by a specified date	Short-term investment funds that commingle commercial paper or futures are exempted
Policies / Statements		
Connecticut State Treasurer's Responsible Gun Policy, adopted and in effect 2/19/20	Prohibits Connecticut Retirement Plans and Trust Funds investment in civilian firearm manufacturing companies Requests banks and financial institutions wanting to work with the Office of the Treasurer to disclose their gun policies Requires state entities to consider such policies when contracting for financial services	Notes flexibility to invest in gun-safe technologies
Massachusetts PRIM Board proxy voting guidelines, effective March 1, 2022	Permits state pension funds to vote against company directors where companies are not aligned with the Paris Accords	
Nevada Treasurer Announcement, June 2022	Announced state divestment from businesses that sell or manufacture assault-style weapons	
New York State Teachers' Retirement System divestment, Dec. 28, 2021	Announced end to further investment in oil and gas and thermal coal reserve holdings, and divestment of thermal coal holdings	
Rhode Island State Pension Initiative, in effect 1/22/20	Requires the state investment commission to divest the public pension fund from companies that manufacture assault-style weapons for civilian use or operate private for-profit prisons	

6. State Measures Requiring Corporations to Disclose GHG Emissions or Climate-related Risks to the State

Finally, lawmakers in California and New York have introduced bills that would require corporations to track and disclose regularly the GHG emissions they generate through their business activities.[33] The California bill would require the California State Air Resources Board to develop and implement regulations requiring U.S. corporations doing business in California and with $1 billion or more in annual revenue to publicly report their Scope 1, 2 and 3 carbon emissions to an emissions registry.

33 *See* **California** SB 253; **New York** A 4123 (would require businesses with over $500 million revenue to report to the Air Resources Board the company's climate-related financial risks and measures to address such risk, and to make certain public disclosures); and **New York** S 897 (would require businesses with over $1 billion in revenue to report Scopes 1, 2 and 3 emissions annually to an emissions registry and to independently verify the disclosures).

The bill was proposed with two additional climate-related bills[34] and is notable in several respects.

First, although the bill has been compared to the SEC's proposed climate risk disclosure rule for publicly-listed companies, the California bill would also apply to private companies.

Second, the bill would require all companies to disclose the full range of their carbon emissions, including Scope 3 emissions, and to submit all such disclosures to independent review by the registry or an approved third-party auditor. By contrast, the SEC proposal would require the disclosure of Scope 3 emissions under specified circumstances[35] and would not require any type of verification or assurance over Scope 3 emissions disclosures. Note the California bill recognizes the burden in obtaining Scope 3 emissions data, and that additional time may be needed to obtain it.[36]

Third, the bill was introduced less than six months after its predecessor failed to pass the California Senate (by one vote) and contains disclosure requirements that are nearly identical to those in that bill. According to one lawmaker that introduced the bill, SB 253 has garnered more support. The bill is set for a hearing on March 15.

California lawmakers have separately introduced a bill that would require corporations to disclose climate-related risks in a report annually in accordance with the recommended framework and disclosures published by the Task Force on Climate-related Financial Disclosures and steps being taken to mitigate and adapt to disclosed climate-related financial risks.[37]

34 The Climate-Related Financial Risk Act (SB 261) and the Fossil Fuel Divestment Act (SB 252).

35 As proposed, the SEC rule would require a company to disclose GHG Scope 3 emissions if material or if the company has set a GHG emissions target or goal that includes Scope 3 emissions.

36 Specifically, the bill provides that regulations adopted by the State Air Resources Board may grant up to an additional 180 days to furnish Scope 3 emissions disclosures.

37 *See* **California** SB 261 (would require in-scope companies to prepare a climate-related financial risk report disclosing climate-related financial risks and measures adopted to reduce and adapt to disclosed risks).

Conclusion

As regulatory oversight of ESG tightens in the EU and U.K., with additional disclosure and more substantive requirements in this area coming online, the U.S. landscape is becoming increasingly fractured. States are moving in opposite directions, while ESG is also becoming a political fight at the federal level. This puts companies and investment managers in the difficult position of navigating business and politics while seeking to protect their interests and investments. Given the vast number and intricacy of these state measures, and the rapidity with which they are being introduced and implemented, companies are wise to monitor developments in this space closely, and to assess what steps may be prudent, given potential impacts associated with such measures.

Visit our ESG Practice Page to stay informed about developments in this area.

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