Memorandum

Florida Passes Farthest-Reaching Anti-ESG Law to Date

May 2, 2023

On May 2, 2023, Florida's Governor Ron DeSantis signed into law a bill designed to block the consideration of ESG factors in investment decisions. Going further than similar laws enacted in other states,[1] with the passage of House Bill 3[2] ("**HB 3**"), Florida presents itself as a new standard-bearer in America's anti-ESG movement. In requiring that investment decisions (and proxy voting decisions) for state pension assets be made on the basis of "pecuniary factors" only, the law echoes bills already passed in other states. But HB 3 also limits investment decisions for local governments, trust funds, and the state's CFO. It prohibits the issuance of any ESG bonds in the state, limits state contracting, redefines what it means to be a qualified public depository, and imposes new external communications disclaimer requirements.

Below, we summarize the key provisions of HB 3 and offer a comparison against some of the anti-ESG laws on the books in other states.[3]

- **Definition of "pecuniary factors":** Generally HB 3 defines "pecuniary factors" as those that are expected to have a material effect on the risk and returns of an investment based on appropriate investment horizons consistent with applicable investment objectives and funding policy. A pecuniary factor does *not* include "the consideration of the furtherance of any social, political, or ideological interests."[4] Notably, environmental factors are not explicitly included in the definition though addressed in respect of certain provisions that HB 3 introduces.
    - This definition is *more restrictive* than recent measures signed into law in **Arkansas** and **Montana** that acknowledge circumstances in which ESG considerations may be pecuniary.
    - The definition is *less restrictive* than a recent measure signed into law in **Kentucky** which allows the state to infer a fiduciary has considered or acted on a nonpecuniary interest based on membership in "coalitions, initiatives, agreements or commitments," among others.
- **Retirement system assets investment restriction:** When investing Florida retirement system assets (the fourth largest state retirement system in the United States, representing about $180 billion in assets),[5] HB 3 requires that only pecuniary factors be considered, and that no additional investment risk be undertaken to promote any nonpecuniary factors.

- The provision is potentially *more restrictive* than similar laws addressing investment by public entities generally (or in respect of pensions specifically) in:
  - **Arkansas** and **Montana**, which require fiduciaries of state pension benefit plans to consider only pecuniary factors in investment decisions, but acknowledge circumstances in which ESG considerations may be pecuniary;
  - **Idaho**, which prohibits consideration of ESG characteristics in a manner that could override the prudent investor rule. Public entities serving as fiduciaries to select investment options for participants may offer ESG-preferred investments to participants if they are optional and other sufficient alternatives are offered;
  - **North Dakota**, which prohibits public entities from considering socially responsible criteria in investment decisions for the purpose of obtaining an effect other than a maximized state return. It does not apply if the investment has an equivalent or superior rate of return; and
  - **Utah**, which requires the investment of state funds to be made with the sole purpose of maximizing the risk-adjusted return on investments, but exempts certain funds.
- The provision is potentially *less restrictive* than laws coming into effect in:
  - **Kansas** and **Kentucky**, which will similarly prohibit investments that further nonpecuniary interests, but also provide extensive examples of how the advancement of prohibited interests may be demonstrated.[6]
- The provision is *similar to* a bill proposed and proceeding in **Texas**, which is specifically directed at retirement systems.

- **Proxy voting restriction and reporting:** HB 3 requires shareholder rights like proxy voting to be exercised only on the basis of pecuniary factors, with no additional investment risk taken to promote any nonpecuniary factor. HB 3 also requires retirement systems and plans to offer annual reporting to the Governor, state House, state Senate and other state governmental bodies on their governance policies, voting decisions and adherence to fiduciary standards.
  - The voting restriction is *more restrictive* than similar laws in:
    - **Idaho**, which requires proxies delegated to an investment agent to be exercised in the best interests, and for the exclusive benefit of, the public entity or investment beneficiaries;
    - **Montana**, which prohibits voting on nonpecuniary factors, or (unless no economically practicable alternative is available) following proxy advisor recommendations on voting, unless the proxy advisor commits in writing to follow proxy voting guidelines consistent with the board's obligation to act based solely on pecuniary factors;
    - **West Virginia**, which prohibits shareholder votes for the purpose of furthering nonpecuniary interests, but includes an exception where "reasonable efforts" have been made; and

- laws coming into effect in **Arkansas** and **Kansas**, which prohibit voting on nonpecuniary factors, or (unless no economically practicable alternative is available) following proxy advisor recommendations on voting, unless the proxy adviser commits in writing to follow proxy voting guidelines consistent with the fiduciary's obligations to act based only upon pecuniary factors.

  - The voting restriction is *similar* to laws in **Kentucky** and **Utah**.
  - The reporting provision—its compulsory nature, prescriptiveness and the recipients to whom reporting is owed—is *more restrictive* than other laws currently in place or coming into force in other states. This includes:
    - **Arkansas**, **Kansas** and **West Virginia**, where all proxy votes must be reported annually to each pension benefit plan's board and posted on each board's website, and in Kansas also reported to the joint committee on pensions, investments and benefits;
    - **Idaho**, where all proxy votes must be posted quarterly and may be provided subject to a public records request;
    - **Kentucky**, where all proxy votes must be reported at least quarterly to each retirement system's board and posted on each board's website;
    - **Montana**, which establishes no reporting requirement; and
    - **Utah**, where proxy voting reports must be provided to the state treasurer upon request.

- **Qualified public depositories:** HB 3 revises the definition of a qualified public depository able to accept Florida funds for deposit to include only entities that do not deny or cancel services to a person on the basis of a list of criteria, including political opinions, religious beliefs, any factor related to the person's business sector, and failure to meet environmental or governance standards.[7] HB 3 also requires, for deposits, decisions to be made solely on pecuniary factors, and provides that no decision may be made on the basis of nonpecuniary factors.
  - The provision is *more restrictive* than similar laws in:
    - **Idaho**, which requires state depositories to file affidavits with the state treasurer (including an anti-boycott certification) with noncompliance subject to revocation of the state depository designation; and
    - **Tennessee**, which prohibits the state treasurer from entering into contracts for the state's cash management banking services where the depository has a policy that bars financing to fossil fuel companies, except where services are necessary and services from another contractor are not available.
  - The provision is *less restrictive* than a law in:
    - **Arkansas**, which prohibits funds and financial services providers, including any entity that holds and receives deposits, savings and share accounts, from discriminating against specified industries

or otherwise refusing to deal based on ESG factors, requiring the state treasurer to list and divest all direct and indirect state holdings from same.

- **Investment of trust funds:** HB 3 requires an annual investment adviser or manager certification that all investment decisions made on behalf of state trust funds and the State Board of Administration (Florida's asset management organization responsible for investing state and local government assets) are made solely on the basis of pecuniary factors, and provides that no decision may be made on the basis of nonpecuniary factors.
    - The provision is *more restrictive* than laws in force (and described above) that broadly prohibit public entities from considering nonpecuniary factors in investment decisions, but which do not require an annual certification as to such investment decisions.
- **Local government investing decisions:** HB 3 prohibits the use of ESG investing in all investment decisions at the local level, requiring decisions by fund managers to be made based solely on pecuniary factors, and providing that no decision may be made on the basis of any nonpecuniary factors. The provision is *more restrictive* than laws in force (described above) that apply to investment restrictions at the state as opposed to the local levels.
- **Government contracting:** HB 3 prohibits state agencies and local governments from requesting documentation of a vendor's social, political or ideological interests when determining if the vendor is a responsible vendor, and prohibits giving a preference to vendors on that basis.
    - The restriction is *more restrictive* than a law in:
        - **Idaho**, which prohibits state but not local public procurement decisions from being based on ESG standards.
    - The restriction could be interpreted as *less restrictive* than a law in:
        - **Utah**, which prohibits state and local governmental entities from using a social credit score system in government contracting decisions.
    - The restriction takes a different approach than anti-boycott measures in states that prohibit investments and business decisions with particular agendas and bar governmental entities from doing business with firms that are deemed boycotters.
- **Additional provisions unique to HB 3:**
    - **ESG bonds:** HB 3 prohibits the issuance of state or municipal ESG bonds.[8] It also prohibits issuers from expending public funds or using moneys derived from bond issuances to pay for third-party verification services related to the designation or labeling of ESG bonds, or entering into a contract with a ratings agency whose ESG ratings for the issuer will have a direct, negative impact on the issuer's bond ratings.

- **External communications disclaimer:** HB 3 requires any communications between an investment manager to a company in which the manager invests public funds on behalf of a governmental entity that discuss ESG interests, or advocate for an entity other than shareholders, to include a conspicuous disclaimer that the views are the sender's and not the state's.
- **Investments determined by CFO:** HB 3 requires investment decisions by Florida's CFO (an elected position who also serves as a member of the Florida Cabinet) to consider only pecuniary factors, and prohibits decisions that promote any nonpecuniary factors.

The law also covers other topics, including in relation to money services businesses, licensing and citizen support and direct-support organizations.

Conclusion

The degree of overlap between HB 3 and the priorities set out by a multistate alliance of 19 Republican governors, led by Governor DeSantis, is notable.[9] While the group has no legal authority, HB 3 may become a roadmap for the other states whose governors joined DeSantis in the alliance.

Although comments from GOP lawmakers and sponsors of FL HB 3 have hastened to emphasize that the law will not prevent investments with companies that use ESG ratings as long as there's a predictable return, or in ESG-related funds, individually and collectively, the component measures increase liability risk for persons and entities subject to the law without apparently extending benefits to them.

HB 3 was not without its critics in both chambers, including some GOP state lawmakers and pension trustees who decried the bill's overreach and warned of economic consequences including projected losses in their pension systems.[10] Ultimately, unlike in other states where powerful constituencies succeeded in tempering certain measures or defeating bills, HB 3 was in essence enacted as lawmakers and bill sponsors originally proposed.

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[1] *See* our memo ESG Battlegrounds: How the States Are Shaping the Regulatory Landscape in the U.S. (updated monthly) for a full list of the enacted and proposed state-level ESG-focused laws.

[2] **Florida** HB 3 (signed into law 5/2/23, in effect 7/1/23).

[3] The state laws referred to herein are as follows: **Arkansas** HB 1253 (in effect 5/1/23), **Arkansas** HB 1307 (in effect 90 days after Sine Die, 5/1/23, so likely end of July/August 1), **Montana** HB 228 (in effect 4/19/23), **Idaho** SB 1405 (in effect 7/1/22), **Idaho** HB 190 (signed by Governor on 3/31/23, in effect 7/1/23), **Idaho** HB 191 (signed into law 3/23/23, in effect 7/1/23), **Indiana** HB 1008 (awaiting Governor's signature), **Kansas** HB 2100 (passed without Governor's signature on 4/25/23, in effect 7/1/23), **Kentucky** SB 205 (in effect 4/8/22), **Kentucky** HB 236 (signed by Governor on 3/24/23, in effect 6/29/23), **Montana** HB 228 (in effect 4/19/23), **North Dakota** SB 2291 (in effect 3/24/21), **Oklahoma** HB 2034 (in effect 11/1/22), **Tennessee** SB 2649 (in effect 7/1/22), **Texas** SB 1446/HB 2068 (passed by Senate, signed by House), **Texas** SB 13 (in effect 9/1/21), **Texas** SB 19 (in effect 9/1/21); **Utah** SB 97 (signed by Governor on 3/14/23, in effect 5/3/23), **Utah** SB 96 (signed by Governor on 3/14/23, in effect 5/3/23), **West Virginia** HB 2862 (approved by Governor on 3/28/23, in effect 6/8/23).

[4] The definition of "pecuniary factors" largely tracks the definition under the Financial Factors regulation promulgated under the Trump Administration—with one critical distinction. Whereas the Financial Factors rule recognized that one or more ESG factors may indeed be a pecuniary factor, HB 3 contains a carve-out.

[5] *See* Florida Department of Management Services, Division of Retirement, available here.

[6] Kansas Governor Laura Kelly allowed the measure to become law without her signature and vetoing more than a dozen other measures approved by the state's GOP-controlled Legislature addressing abortion, transgender rights and other issues.

[7] Entities cannot deny service based on political opinions, religious beliefs, any standard that is not quantitative and risk-based; any rating, scoring analysis or action that considers a "social credit score" based on factors including political beliefs, religious beliefs, legal firearms ownership, firearms manufacture, fossil fuel-based energy, timber, mining or agriculture; support for combatting illegal immigration manufacturing or sale, support for combatting illegal immigration; failure to meet environmental standards, social governance standards, board composition standards or policies encouraging diversity, equity and inclusion.

[8] "ESG bonds" is defined as any bonds designated or labeled as bonds used to finance a project with an ESG purpose, including green bonds, social bonds, sustainability bonds and SDG bonds (both those self-designated by an issuer and by an external third-party verifier. The section does not apply to bonds issued before July 1, 2023 or to any agreement entered into or contract executed before July 1, 2023.

[9] Joint Governors Policy Statement on ESG (March 16, 2023), available here (urging policies that block the use of ESG in all state and local investment decisions, limit the ability of state agencies and municipalities to issue ESG bonds and restrict financial institutions from using "social credit scores"); Governor Ron DeSantis Leads Alliance of 18 States to Fight Against Biden's ESG Financial Fraud (March 16, 2023), press release available here.

[10] *See, e.g.,* Jim Turner, "Florida House moves forward with bill that would prevent 'progressive' government investments," *Orlando Weekly* Mar. 8, 2023, available here.