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# Is the U.S. Anti-ESG Movement Sustainable?

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## <Summary>

- In the United States, an anti-ESG (environmental, social, and governance) movement led by Republicans and conservative think tanks has been gaining momentum in recent years. The main claims of the anti-ESG movement include: 1) prohibiting or restricting asset management companies from investing or voting with ESG factors in mind, 2) prohibiting investment in or contracting with financial institutions that "boycott" fossil fuel and firearms industries on ESG grounds, and 3) alleging that financial institution alliances committed to decarbonize their portfolios could constitute antitrust law violations.

- With pressure for decarbonization that is targeting the fossil fuel industry and other industries increasing, the anti-ESG movement is more likely to gain traction in red states (states with Republican political leadership) such as Texas, where these industries account for a large share of the state economy. Furthermore, the anti-ESG movement is being strongly promoted by Republican legislators and state governors who want to solidify their support base in the run-up to the November 2024 presidential election and congressional/gubernatorial elections.

- The anti-ESG movement is rooted in the growing U.S. social divide, and the gap between Democratic and Republican supporters in terms of values regarding climate change and environmental conservation is widening further. The U.S. anti-ESG movement is therefore not transitory, but instead sustainable. In short, it will continue over the medium term. If a Republican presidential candidate wins in November 2024, we could see the introduction of new ESG regulations and another withdrawal from the Paris Agreement.

- Strengthening ESG factors not only reduces business risks and increases companies' resilience to systemic risks such as climate change over the longer term, but also contributes to enhancing enterprise value by building trust with customers, shareholders, employees,


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and society. It is therefore important for companies (including Japanese ones) to carefully monitor developments on both sides of the ESG debate and to move forward with ESG in a steady, continuous, and strategic manner in line with their own corporate purposes and management philosophies, without being swayed by U.S. political trends.

◆ Financial institutions and institutional investors should remain steadfast in supporting corporate transformation, including decarbonization, by leveraging their insights to provide solutions and through engagement with long-range time horizons. In addition, it will be necessary to understand the actual ESG status of companies and improve the transparency and credibility of ESG rating methodologies, in order to demonstrate the correlation between ESG factors and investment performance over the medium- to long-term and to create a social consensus on ESG.

- **This is a English version of "米国の反 ESG 運動はサステナブルか？" in JRI Viewpoint (The original version is available at https://www.jri.co.jp/MediaLibrary/file/report/viewpoint/pdf/14460.pdf)**

## 1. The anti-ESG movement is gathering steam in the U.S.

In the United States, an anti-ESG (environmental, social, and governance) movement led by Republicans and conservative think tanks[1] has been gaining momentum in recent years. The main claims of the anti-ESG movement include: 1) prohibiting or restricting asset management companies from investing or voting with ESG factors in mind, 2) prohibiting investment in or contracting with financial institutions that "boycott" fossil fuel and firearms industries on ESG grounds, and 3) alleging that financial institution alliances committed to decarbonize their portfolios could constitute antitrust law violations. Let us examine each of them in turn:

### (1) Prohibiting or restricting asset management companies from investing or voting with ESG factors in mind

The first main claim of the anti-ESG movement is directed against asset management companies (fiduciaries) that are entrusted with managing funds of private-sector corporate pensions and public employee retirement systems. The proponents argue that fiduciaries must select investees and exercise voting rights based only on "pecuniary factors" for the interests of the plan participants and beneficiaries. They claim that investing and voting based on "politicized investment strategies" such as ESG poses inappropriate investment risk or leads to diminished returns on assets under management and violates fiduciary duty.

In February 2023, the House and Senate, led by Republicans, passed a joint resolution to nullify a new rule issued by the Department of Labor (DOL) in December 2022[2]. The DOL rule (which came into force in January 2023) is concerned about the Employee Retirement Income Security Act (ERISA) and clarified that corporate pension fiduciaries may consider "ESG factors" when selecting investees and investment policies as well as when exercising voting rights[3]. Responding to the joint resolution, in March 2023 President Biden exercised his right to veto it, stating, "This resolution would prevent retirement plan fiduciaries from taking into account factors, such as the physical risks of climate change and poor corporate governance, that could affect investment returns. Retirement plan fiduciaries should be able to consider any factor that maximizes financial returns for retirees across the country. That is not controversial － that is common sense."

In July 2023, the Republican-led House of Representatives Financial Services Committee approved a proposal to establish the Protecting Americans' Retirement Savings from Politics Act (H.R. 4767) and referred the bill to the House. The legislation would allow corporations to exclude environmental, social, and political shareholder proposals from shareholder meeting materials, introduce a registration system for proxy advisory firms, and require these firms to demonstrate transparency and accountability in their provision of advice. Furthermore, if a large asset management company were planning to exercise voting rights with respect to a

[1] The Heritage Foundation, Texas Public Policy Foundation (TPPF), American Legislative Exchange Council (ALEC), Opportunity Solutions Project (OSP) are supporters of the anti-ESG movement led by Republicans.

[2] Although Democrats form a majority in the Senate, two Democrats voted in favor, so the Senate passed the joint resolution. Like a bill, a joint resolution requires the approval of both Chambers in identical form and the president's signature to become law.

[3] In November 2020, with the Trump Administration still in charge, the Department of Labor issued a rule, "Financial Factors in Selecting Plan Investments," and in December 2020 it issued another rule, "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights" (both taking effect in January 2021). These rules required corporate pension plan fiduciaries, in principle, to select investees and exercise voting rights based solely on "pecuniary factors." The new rule does not change the Department of Labor's basic position that sacrificing returns or taking on more risk for ancillary objectives such as environmental protection or human rights protection runs contrary to fiduciary responsibility. However, it does give fiduciaries more flexibility in taking ESG factors into account when deciding where to invest.

shareholder proposal put before the shareholders of a company in its portfolio, and it were planning to vote in the opposite way to that recommended by the company's board of directors, it would need to confirm that this would be in the "best economic interest" of the true shareholders, by performing an economic analysis (and disclose this in its annual report on the exercise of voting rights). In addition, fiduciaries of passively managed funds would be prohibited from exercising voting rights contrary to the recommendations of the board of directors of the portfolio company, unless the true shareholder has instructed the fiduciary to do so.

At the state level, too, a series of laws have been passed in red states (states under Republican control)[4] that require asset management companies, as fiduciaries of state and local public employee retirement systems, to consider only "pecuniary factors" and prohibit them in principle from making investment decisions or voting based on ESG factors[5].

### (2) Prohibiting investment in or contracting with financial institutions that “boycott” fossil fuel and firearms industries on ESG grounds

The second main claim of the anti-ESG movement targets financial institutions and companies that are "boycotting" (i.e., refusing or restricting services) certain industries, such as the fossil fuel and firearms sectors, on ESG grounds. The idea is that state and local public employee retirement systems should be prohibited from investing in these financial institutions and companies, and that states as well as local governments within states should be banned from contracting with them.

The pioneer is the red state of Texas. In June 2021, Governor Greg Abbott signed off on a state law that prohibits public employee retirement systems within the State of Texas from investing in financial institutions and others that boycott the fossil fuel industry without normal business reasons for doing so, and blocks state and local governments from entering into goods and services contracts worth $100,000 or more with them. At the same time, another state law was also enacted (with both taking effect in September 2021) that bans state and local governments from awarding contracts worth $100,000 or more to companies with discriminatory practices or policies against the firearm or ammunition industries. Financial institutions and other entities that enter into contracts with the state or local governments must certify in writing in advance that they are not boycotting or discriminating against the target industries and will not do so during the term of the contract. In response, major municipal bond underwriters such as JPMorgan Chase, Citigroup, and Bank of America withdrew from the Texas municipal bond market, with failure to demonstrate compliance with the new laws cited as the reason. Furthermore, in August 2022, the State of Texas released a “list of financial companies that boycott energy companies" and ordered state and local public employee retirement systems and other bodies to divest or withdraw their investments in these institutions. Since then, other red states have passed a series of "anti-boycott laws" for specific industries similar to those in Texas[6].

4 Republicans holds the state governorship as well as control of both branches of the state legislature (trifecta) in 22 states, while Democrats hold 17 state trifectas.

5 As of 2023, these Republican states included Utah, Kentucky, Arkansas, Montana, Indiana, Kansas, Louisiana, North Carolina, and West Virginia. In May, Florida passed a comprehensive anti-ESG law with similar provisions.

6 In 2022, West Virginia, Kentucky, and Oklahoma passed similar state laws, and in 2023, states including Alabama, Arkansas, Utah, and Idaho did so.

In addition, 19 state governors affiliated with the Republican Party issued a joint statement in March 2023 announcing their intention to lead anti-ESG efforts at the state level. Specifically, their plan involves 1) blocking the use of ESG in all investment decisions at the state and local level, ensuring that only financial factors are considered, 2) eliminating consideration of ESG factors by states and local governments when issuing bonds, 3) prohibiting state fund managers from considering ESG factors when investing taxpayer money, and 4) prohibiting financial institutions from considering so-called "Social Credit Scores" to screen customers.

Against this backdrop, Florida Governor Ron DeSantis signed comprehensive anti-ESG legislation into law in May 2023 (which took effect in July 2023). The law prohibits, in principle, ESG-conscious investment decisions and the ESG-conscious exercise of voting rights in state and local public employee retirement systems, as well as boycotts of certain industries by financial institutions, describing such actions as "unsafe and unsound practices" (Table 1). Florida's anti-ESG law could be construed as a political message from DeSantis, who is seeking the Republican nomination for the next presidential election, aimed at firming up support among conservative voters.

**Table 1. Key Components of Florida's Anti-ESG Law**

| |
|---|
| 1) Requires the state and local governments within the state to make investment decisions based solely on "pecuniary factors." |
| 2) Requires that investment decisions and exercise of voting rights in the public employee retirement systems of the state and local governments within the state be based solely on "pecuniary factors." Each year, investment advisors or managers must certify in writing that investment decisions are based solely on "pecuniary factors." |
| 3) Prohibits the issuance of ESG bonds by the state and municipalities within the state. |
| 4) Prohibits the selection of vendors for public procurement based on the vendor's social, political, or ideological interests. |
| 5) Stipulates that financial institutions must decide whether to provide financial services based on an analysis of customer-specific risk factors. Engaging in "unsafe and unsound practices" is also banned. Specifically, "unsafe and unsound practices" are defined as refusing to provide financial services to or discriminating against a person based on evaluation or scoring that is based on factors such as legal firearms ownership or manufacture of firearms or ammunition; engagement in exploration, production, or sale of fossil fuel energy, mining, or other activities; or failure to meet environmental or ESG standards, including emission standards. Financial institutions regulated by state authorities are required to submit compliance attestation annually, and sanctions can be imposed for failure to submit in a timely manner. |
| 6) Qualified public depositories (QPDs) that accept state deposits are also prohibited from engaging in "unsafe and unsound practices." Financial institutions must attest their compliance before being designated or re-designated as QPDs. Failure to attest is grounds for suspension or loss of QPD status. |

Source: Prepared by JRI based on data from Florida CS/CS/HB 3 (2023)

### (3) Alleging that financial institution alliances committed to decarbonize their portfolios could constitute antitrust law violations

The third main claim of the anti-ESG movement is that financial institutions acting in concert with their competitors to decarbonize not only their own emissions but also those from companies in their portfolios may violate U.S. antitrust law.

In recent years, financial institutions around the world have joined alliances to promote joint efforts to decarbonize portfolio holdings with the goal of achieving net zero by 2050 (Table 2).

**Table 2. Financial Alliances for Net Zero and Major Financial Institutions that Have Left Them**

| | Net-Zero Asset Managers initiative (NZAM) | Net-Zero Asset Owner Alliance (NZAOA) | Net-Zero Insurance Alliance (NZIA) |
|---|---|---|---|
| Description | Global initiative by asset management companies aiming to achieve net-zero GHG emissions from their investee companies by 2050 | International alliance of asset owners aiming to achieve net-zero GHG emissions from their asset management portfolios by 2050 | International alliance of insurance companies aiming to achieve net-zero GHG emissions from their underwriting portfolios by 2050 |
| Member Financial Institutions | 356 asset management companies (as of June 30, 2023) | 86 asset owners (life insurers, funds, etc.) (as of August 31, 2023) | 11 insurance companies (as of August 31, 2023) |
| Financial Institutions that Left the Alliance | Vanguard left in December 2022<br>Green Century Capital Management left in March 2023 | HanseMerkur left in May 2023<br>Church of England Pensions Board left in June 2023 | Munich Re left in March 2023<br>Zurich Insurance and Hannover Re left in April 2023<br>SCor, Corporation of Lloyd's, Swiss Re, Allianz, AXA, Tokio Marine Holdings, MS&AD Insurance Group Holdings, and Sompo Holdings left in May 2023 |

Source: Prepared by JRI based on various materials
Note: Other alliances include the Net-Zero Banking Alliance (NZBA), the Net-Zero Investment Consultants Initiative (NZICI), and the Net-Zero Financial Service Providers Alliance (NZFSPA).

Meanwhile, a group of Republican state attorneys general sent an open letter to 53 U.S. asset management companies in March 2023. In addition to noting fiduciary responsibility concerns, the letter argues that agreements with competitors regarding voting and engagement with companies, such as through the Climate Action 100+[7] and the Net Zero Asset Managers initiative (NZAM), which is aimed at achieving net zero GHG emissions by 2050, could unduly restrict competition. In May 2023, the group also sent an open letter to the Net Zero Insurance Alliance (NZIA), an international network of non-life insurance companies, requesting answers

[7] Climate Action 100+ is an international network that focuses on 171 large companies with high GHG emissions, supporting institutional investor engagement to encourage the world's largest corporate GHG emitters to take action deemed necessary.

to questions regarding the possibility that joint action by NZIA member insurance companies to achieve net zero emissions in their insurance and reinsurance underwriting portfolios could violate U.S. antitrust law.

And in June 2023, the House Judiciary Committee, chaired by a Republican member of the House, subpoenaed the CEO of Ceres[8] to produce documents and communications related to the efforts of Climate Action 100+, which Ceres is leading in North America, claiming that the initiative may violate U.S. antitrust law. Also in July, the Chair of the House Judiciary Committee and two Republican members of the House sent a letter to the Glasgow Financial Alliance for Net Zero (GFANZ), the world's largest financial coalition committed to net-zero GHG emissions by 2050, as well as NZAM, Vanguard, BlackRock, and State Street Global Advisors, requesting information on their ESG initiatives that they allege may violate U.S. antitrust law[9].

In response to these developments, Vanguard left NZAM in December 2022, and since the beginning of 2023, a number of non-life insurers have quit NZIA due to concerns about heightened litigation risk and reputational risk (Figure 2 on the previous page).

## 2. Future outlook for the anti-ESG movement

As pressure mounts on the fossil fuel sector and other industries that are large GHG emitters, the anti-ESG movement is more likely to gain traction in red states such as Texas, where these industries account for a large share of the state economy. Furthermore, the anti-ESG movement is being strongly promoted by Republican legislators and state governors who want to solidify their support base in the run-up to the November 2024 presidential election and congressional/gubernatorial elections.

The anti-ESG movement is rooted essentially in the growing U.S. social divide, and the gap between Democratic and Republican supporters in terms of values regarding climate change and environmental conservation is widening further[10]. Republicans and conservative think tanks have positioned ESG as "the Left's political tool for pushing businesses and financial institutions to advance progressive ideology in American Society" (Heritage Foundation). The stronger the global push for decarbonization and other sustainability initiatives becomes, the stronger the opposition of the Republican Party and its supporters to such moves is expected to become. Therefore, it seems that the anti-ESG movement in the U.S. is not transitory, but rather sustainable, i.e., is highly likely to continue over the medium term, as differences in values become more pronounced.

Given these circumstances, if a Republican candidate wins the presidential election in November 2024, we could see not only the re-nullification of the Department of Labor's ESG rule under ERISA, but also the introduction of new ESG regulations and another withdrawal from the Paris Agreement[11]. In addition, it is

[8] Ceres is a founding member of Climate Action 100+ and facilitates engagement between high GHG emitting companies and institutional investors in North America.

[9] In August 2023, the Committee on the Judiciary sent a letter to the proxy advisory firms Institutional Shareholder Services (ISS) and Glass Lewis, requesting documents and communications related to matters such as the promotion of decarbonization targets.

[10] According to a poll by U.S. research firm Gallup (conducted in March 2023), 78% of Democrats say they "prioritize environment over economy," compared to 20% of Republicans. This 58-point gap is the largest gap between the two since 1984. And a survey by the Pew Research Center, another U.S. research firm, also found a partisan divide in perceptions of climate change.

[11] In May 2022, former Vice President Mike Pence wrote a piece for the *Wall Street Journal* under the title "Republicans Can Stop ESG Political Bias - The progressive left is using it to advance goals it could never hope to achieve at the ballot box." In it, he argued that "ESG scores are not only inherently political, but completely subjective and often hypocritical," and that "most important, the next Republican president and GOP Congress should work to end the use of ESG principles nationwide."

highly likely that antitrust lawsuits concerning engagement (i.e., dialogue with investee companies) between financial institutions and major GHG emitters will continue to be filed in the future. Financial institutions will therefore need to be extremely careful to ensure compliance with antitrust law[12].

On the other hand, some of the red state legislation excluding ESG-conscious financial institutions and companies from state and local government contracts goes against the pro-business stance of traditional Republicans, who have pursued and benefited from the support of corporations and financial institutions. Critics also argue that requiring public employee retirement systems to divest or withdraw their investments in such financial institutions and companies, or excluding these entities from public contracts, would result in significant cost increases for retirees and taxpayers[13]. Considering these factors, rather than distorting market competition through sweeping regulations on corporate behavior, a more moderate approach that restricts the consideration of ESG factors become more widespread in the future to keep regulatory costs under control[14].

## 3. Corporate responses and implications for Japanese companies

The number of shareholder proposals put before annual general meetings of U.S. companies is increasing every year, with proposals calling for specific actions on climate change, human rights, etc. now being joined by ones from the "anti-ESG" side[15]. In addition, the shareholder support for environment-related proposals in the 2023 proxy season decreased from the prior season[16]. This reflects the fact that companies had already made substantial progress on ESG, as well as the burgeoning anti-ESG movement in the U.S.

As the environmental and social issues that humankind needs to consider become more serious, strengthening ESG factors not only reduces business risks and increases companies' resilience to systemic risks such as climate change over the longer term, but also contributes to enhancing enterprise value by building trust with customers, shareholders, employees, and society[17]. For this reason, even if the anti-ESG movement in the U.S. remains a force in the medium term, it can be expected to gradually lose steam in the longer term and converge with the worldwide trend to emphasize ESG. It is therefore important for companies (including Japanese ones) to

[12] ESG initiatives coordinated among competing firms, such as joint rejection of deals, group boycotts, and information sharing on transaction terms and conditions, are highly likely to be in breach of antitrust law.

[13] A joint paper by a Chicago Fed economist and a Wharton School assistant professor, "Gas, Guns, and Governments: Financial Costs of Anti-ESG Policies" (January 2023), notes that as a result of Texas enacting anti-ESG legislation in June 2021 and the exit of five of the largest municipal bond underwriters from the state, municipal bond issuers in the state faced an increased interest rate burden of $300-500 million in the eight months following the enactment of the laws.
(https://www.chicagofed.org/-/media/publications/working-papers/2023/wp2023-07.pdf?sc_lang=en)

[14] In January 2023, an anti-ESG bill that would apply to the Indiana Public Retirement System (IPRS) was introduced in that state. Under it, the IPRS would have been forbidden from entrusting assets to asset management companies that have made "ESG commitments" (including promoting decarbonization through engagement, exercise of voting rights, and limiting investments in firearms makers, fossil fuel companies). When the IPRS reported that the bill would reduce returns on assets under management by an estimated $6.7 billion over the next 10 years, the state legislature passed the modified bill allowing a wide range of exceptions to the ban (this modified law was projected to increase administrative costs by $550,000 per year).

[15] According to U.S. firm ISS Corporate Solutions, the number of shareholder proposals to the top 3,000 U.S. listed companies by market capitalization that held shareholder meetings from January to May 2023 was 682, a record high for the past five years, with the rise due mainly to an increase in proposals related to social issues and the anti-ESG movement.

[16] Diligent's 2023 Proxy Season Review found the percentage of votes in favor of environment-related shareholder proposals put to the vote at U.S. corporate shareholder meetings to be 21.7% in 2023, down significantly from 41.2% in 2021. The figure for social-related proposals also decreased to 17.7% in 2023 from 35.7% in 2021.

[17] As President Biden stated when he vetoed the joint resolution of both houses of Congress (see page 3), "There is extensive evidence showing that environmental, social, and governance factors can have a material impact on markets, industries, and businesses." Overall, studies finding a positive correlation between ESG performance and enterprise value are in the majority.

carefully monitor developments on both sides of the ESG debate and to move forward with ESG in a steady, continuous, and strategic manner in line with their own corporate purposes and management philosophies, without being swayed by U.S. political trends.

Financial institutions and institutional investors should not simply stop investing in or lending to specific industries due to ESG concerns, and not excessively constrain corporate management with ESG. Instead, they should remain steadfast in supporting corporate transformation, including decarbonization, by leveraging their insights to provide solutions and through engagement with long-range time horizons. It is also true that challenges still exist in understanding the actual ESG status of companies[18], such as whether their plans for transitioning to decarbonization are credible and feasible, and in the transparency and credibility of ESG rating methodologies[19]. It will be necessary to tackle these issues on an ongoing basis to demonstrate the correlation between ESG factors and investment performance over the medium- to long-term and to create a social consensus on ESG.

Since the anti-ESG movement is rooted in the division of values in U.S. society, its impact on Japan, let alone Europe, is expected to be small. However, depending on the outcome of the 2024 presidential election, it is possible to envisage a shift in U.S. decarbonization policies[20] and a further expansion of the anti-ESG movement. If the anti-ESG movement gains further momentum in the U.S., it could have an impact on shareholder proposals and voting trends at shareholder meetings of Japanese companies, as well as on the business and practices of Japanese companies, financial institutions, and institutional investors operating in the U.S. It will therefore be essential to keep a close eye on future developments.

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[18] To accurately ascertain corporate ESG efforts, enhanced non-financial information disclosure and tighter regulations against sustainability-washing will be required.

[19] OECD, "Policy guidance on market practices to strengthen ESG investing and finance a climate transition" (October 2022) and "ESG Investing and Climate Transition: Market Practices, Issues and Policy Considerations" (October 2021).

[20] The U.S. 2050 carbon neutral goal is not enshrined in law. Japan and European countries have made their climate targets legally binding through the enactment of laws.