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Republicans Reintroduce House Bill to Limit ESG Considerations in Retirement Investing

August 1, 2023

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On June 21, two Republican members of Congress renewed efforts to enact legislation that arguably would restrict investment managers from taking into account ESG considerations in investing on behalf of retirement funds. U.S. Representatives Andy Barr (R-Ky.) and Rick Allen (R-Ga.) reintroduced the Ensuring Sound Guidance (ESG) Act, which would require investment advisers and ERISA retirement plan sponsors to consider "only pecuniary factors" in acting in the best interests of clients.

The bill, **H.R. 4237**, would amend the Investment Advisers Act of 1940 and the Employee Retirement Income Security Act of 1974 (ERISA). Text of the bill has not yet been made available on the 118th Congress's legislation portal. But the previous version of the bill, introduced in 2022 as **H.R. 7151**, stated that a client's best interests would be determined using only pecuniary factors, unless the client specifically requested that non-pecuniary factors be considered. The previous version of the bill defined "pecuniary factor" as "a factor that a fiduciary prudently determines is expected to have a material effect on the risk and return of an investment based on appropriate investment horizons consistent with the plan's investment objectives and the funding policy established pursuant to section 402(b)(1)."

"We must take significant action to protect retail investors and retirees from the cancer within our capital markets that is ESG, which prioritizes higher-fee, less diversified and lower return investments," **Barr said in a statement**. If introduced, the ESG Act would represent a challenge to a **November 2022 Department of Labor rule** providing that, consistent with the fiduciary duties of prudence and loyalty under ERISA, retirement plan fiduciaries may consider ESG factors when selecting investment and exercising shareholder rights, such as voting proxies. According to a fact sheet accompanying the DOL rule, "a fiduciary's duty of prudence must be based on factors that the fiduciary reasonably determines are relevant to a risk and return analysis and that such factors may include the economic effects of climate change and other ESG considerations on the particular investment or investment course of action."

Taking the Temperature: The reintroduced proposed ESG Act is yet another challenge to the Biden Administration's Department of Labor rule, which overturned previous restrictions on the ability of retirement plan fiduciaries to consider ESG-related factors in their investment decisions. Earlier this year, Congress passed a joint resolution that

“disapproved” of the DOL rule. The measure was vetoed by President Biden in March. In January, twenty-five Republican state attorneys commenced an action in the Northern District of Texas against the DOL seeking to “hold unlawful and set aside” the rule governing how retirement plan managers can consider climate change and other ESG factors. In February, two participants in ERISA-regulated plans commenced an action in the Eastern District of Wisconsin claiming that the DOL rule exceeds the authority granted under ERISA.

The proposed ESG Act forms part of the evolving landscape of political resistance to climate change legislation and initiatives. We have observed that, prior to President Biden’s veto, Republican governors of 19 states announced an alliance led by Florida Governor Ron DeSantis to push back against the Biden Administration’s purported ESG “agenda.” In addition to initiatives seeking to resist legislation and regulation, the last year has seen anti-ESG groups challenge financial institutions and their investment strategies. Recent examples include the Consumers’ Research’s campaign against Bank of America, a letter from several Republican Attorneys General to over 50 U.S. asset managers suggesting that ESG investment practices violated federal and state antitrust and consumer protection laws, and efforts by Republican-led state legislatures to impose penalties on financial institutions deemed insufficiently supportive of the energy industry.

As we have observed on numerous occasions, it is difficult to see how a position that asset managers must disregard all ESG factors when making investment decisions can be squared with well-established fiduciary duties to consider all material risk factors. As BlackRock recently observed, climate risk and the economic opportunities from climate transition are top concerns for many clients and its participation in ESG initiatives is “entirely consistent with our fiduciary obligations.”

EU's General Court Dismisses Action by MEP Against the Commission's Inclusion of Nuclear Energy and Natural Gas in the EU Taxonomy

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On June 21, 2023, the General Court of the European Union **rejected an action** brought by a Member of the European Parliament (MEP) seeking to annul European Commission legislation that identified certain activities related to nuclear power and natural gas as environmentally sustainable economic activities. In bringing the action, **MEP René Repasi claimed** that the Commission exceeded the powers conferred upon it when it adopted the Delegated Regulation 2022/1214, which establishes the criteria upon which certain economic activities can be deemed transitional activities contributing to the EU's climate-change mitigation objectives. The General Court ruled the action was inadmissible on the basis that Repasi had no legal standing or direct concern over the adoption of the Delegated Regulation.

In 2020, the European Commission adopted **Regulation 2020/852 (the Taxonomy Regulation)** providing a classification system for economic activities to be considered as environmentally sustainable. The Taxonomy Regulation forms part of the European Green Deal, a suite of regulations forming the EU's plan for addressing the challenges associated with climate change. A key objective is to reorient capital flows towards sustainable investment. The supplementary Delegated Regulation came into force in 2022, and provides for the inclusion of nuclear energy and natural gas in the Taxonomy, thereby labelling them as sustainable investment activities. Repasi argued that the regulation infringed the European Parliament's legislative competence and, therefore, his rights as an MEP.

This case is the first time that the General Court has ruled on the legal standing of an MEP to challenge a delegated regulation of the Commission. The General Court ruled that while MEPs can challenge Commission regulations that directly impact their work, the Delegated Regulation did not directly affect the position of the MEP. The rights and powers Repasi possesses as an MEP, such as participating in law-making and influencing decisions, were intended to be used within the Parliament's rules. The adoption of the regulation did not directly change his position and the General Court dismissed his claim.

Taking the Temperature: The Parliament and the Commission's decision to classify nuclear power and natural gas-related activities as environmentally sustainable has been the subject of much controversy and there are concerns that the overall credibility of the Taxonomy Regulation has been diminished. As we reported recently, Greenpeace filed a lawsuit with the European Court of Justice against the Commission over the inclusion of natural gas and nuclear energy on the basis that it contravened the Taxonomy Regulation as well as the EU's obligations pursuant to the 2015 Paris

Agreement. ClientEarth filed a similar claim over the European Commission's refusal to remove fossil gas from the Taxonomy.

The challenge brought by MEP Repasi is an example of the increasing use of strategic litigation. As we have discussed recently, strategic litigation refers to cases that are filed with the objective of influencing the wider debate around climate change decision-making rather than obtaining a specific judgment or legal remedy. Strategic litigation against governments or state authorities that raise issues around the validity or interpretation of climate change framework laws have increased in the 12 months, according to a report from the Grantham Institute. Other examples include: *Held v. Montana*, a case involving Montana residents who are claiming that the State of Montana violated their constitutional rights by virtue of state support of fossil fuel-based energy policies; and *Greenpeace Italy et. al. v. ENI S.p.A.*, where Italian citizens and two NGOs sued ENI S.p.A asserting violations of their human rights safeguarded by the Italian Constitution by virtue of the company's alleged contributions to climate change.

Swiss Citizens Vote in Favor of New Net Zero Law

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On June 18, 2023 Swiss citizens voted in favor of a **new climate law** intended to promote carbon neutrality by 2050. The Federal Act on Climate Protection Targets, Innovation and Strengthening Energy Security, known as the Climate and Innovation Act, aims to reduce pollution and produce more energy for the country. Switzerland imports approximately three quarters of its energy, including all of its oil and natural gas. Under the Climate and Innovation Act, Switzerland would gradually reduce its consumption of oil and natural gas in order to become climate neutral by 2050. A second goal is for the country to produce more renewable energy in-country, rather than relying on imports.

The climate law **includes a broad package of measures** to achieve net zero, including intermediate national and sector-specific targets for emissions reductions, initiatives to reduce energy consumption, and incentives to help migrate industry, buildings and homes away from the use of fossil fuel-based power. The law requires that, between 2031 and 2040, the country achieve an average of 64% GHG reductions, at least a 75% reduction in 2040, and at least 89% between 2041 and 2050. It also sets specific GHG emissions targets for carbon-intensive sectors.

A majority of Swiss voters — 59% — **approved the new law** with higher majorities in larger cities such as Geneva (74%) and Basel (73%). The country's parliament accepted the law in September 2022, but opposition from the right-wing Swiss People's Party forced a nationwide referendum. Following the passage of the law, the Swiss government must now put in place specific regulatory and legislative measures to achieve the Climate and Innovation Act's stated goals.

Taking the Temperature: The approval of the Climate and Innovation Act follows other climate-related initiatives by Switzerland. As we noted late last year, Switzerland adopted the "Ordinance on Climate Disclosures," which will require large Swiss public companies, banks, and insurance companies to report climate risks using a similar approach to the EU regulatory framework. The measure takes effect on January 1, 2024. The Swiss Federal Council also proposed adopting a narrower definition for sustainable investments earlier this year in an effort to increase clarity for investors and curb greenwashing. Such developments bring Switzerland's approach to fulfilling its obligations under the Paris Agreement closer to alignment to the EU Green Deal.

Switzerland's commitment to climate-change action has been previously criticized for lacking ambition. In particular, the country had entered into carbon credit agreements with, among others, Georgia, Peru, Senegal and Ghana, under which the Swiss government would finance sustainable projects in those countries to effectively cancel out its carbon emissions. The Swiss government had originally planned to offset 12 million tons of carbon – a third of its total planned reductions – through such agreements. However, as we have frequently discussed, carbon credit agreements can lack transparency and effectiveness. Purchasing carbon credits can result in countries focusing less on reducing carbon emissions at home and placing a greater burden on developing countries. It also has been argued that many projects subject to carbon credit agreements would have proceeded even without financing from the relevant country, so-called additionality, which runs contrary to the provisions of the Paris Agreement. Further, in 2021, Swiss voters rejected an amendment to the Federal Act on the Reduction of Greenhouse Gas Emissions, which would have set more ambitious carbon reduction targets.

Australian Financial Regulator Mandated to Adopt Climate Reporting Standards

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In June 2023, the Australian government published an updated **Statement of Expectations** for the Australian Prudential Regulation Authority (APRA), requiring it to, among other things, "promote prudent practices and transparency in relation to climate-related financial risks and the adoption of climate reporting standards by regulated entities." This includes promoting transparency in relation to financial risks and the adoption of climate reporting standards. The new Statement of Expectations follows a consultation that was launched in December 2022 by the Australian government on whether to develop a disclosure framework for organizations, including financial institutions.

A **consultation paper** accompanying the Statement of Expectations proposes mandatory reporting starting in 2024 for Australia's largest companies, whether listed or unlisted, and financial institutions; overarching alignment with international climate disclosure standards; and, perhaps most significantly, a three-year transition period during which only regulators can take action against directors and reporting entities in connection with forward-looking statements and Scope 3 emissions disclosures. After this interim time period, climate-related financial disclosure requirements would transform into civil penalty provisions and be folded into Australia's Corporations Act. Climate disclosures related to Scope 3 emissions and forward-looking statements would then be subject to Australia's more general corporate prohibitions on misleading and deceptive business conduct.

Other initiatives that APRA in particular has taken recently include a 2022 stress-test of Australia's largest banks to assess climate risk on financial stability. **As we reported**, the Climate Vulnerability Assessment highlighted how banks would amend their risk appetites and lending practices with greater climate risk exposure, with an emphasis on potential responses to physical and transition risk.

Taking the Temperature: This latest development in Australia's climate-related policy and regulatory obligations does not come out of the blue. Prime Minister Albanese's government has demonstrated a commitment to reaching net zero by 2050, updating its Nationally Determined Contribution under Article 4 of the Paris Agreement to a more ambitious 43% reduction in GHG emissions by 2030.

As we previously reported, the Australian Treasury announced in December a consultation into proposed rules on climate-related financial disclosure, which will align with the International Sustainability Standards Board (ISSB) recommendations. As we observed at the time, Australia's pursuit of mandatory climate reporting follows the example of many other jurisdictions, including New Zealand, Japan, the European Union and the UK. We also have reported recently on the ISSB's inaugural sustainability standards, IFRS S1 and IFRS S2, which will come into force in January 2024. Australia's Treasury department has signaled that the mandatory climate-related disclosure framework it introduces is likely to follow the ISSB Standards. The Australian Accounting Standards Board is developing sustainability standards which will also be closely aligned with the ISSB Standards.

In parallel, as we reported recently, Australia is aggressively approaching greenwashing enforcement. The Australian Securities and Investments Commission (ASIC) explicitly made greenwashing a key enforcement priority, issuing its first greenwashing fine in October 2022 related to allegedly false or misleading sustainability-related statements made to the Australian Securities Exchange. Earlier this year, ASIC also announced civil penalty proceedings against an Australian superannuation fund for "making misleading statements about the sustainable nature and characteristics" of some of its investment options. As of mid-July 2023, ASIC has reportedly opened nearly three dozen greenwashing investigations.

Association Of British Insurers Releases Guidance for Members on Taking Action Against Nature and Biodiversity Loss

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The Association of British Insurers **published guidance** (the Action on Nature Guide) setting out what insurers and long-term savings providers can do to help prevent biodiversity loss in the UK and become more "nature positive." Recognizing the challenge that many businesses face when trying to assess their impact or reliance on nature, the ABI produced the Action on Nature Guide to assist its member firms to better understand the issues policyholders are facing and how they can protect themselves from the risks associated with nature and biodiversity loss.

The ABI cited several compelling reasons for the sector to take action:

- nature loss exposes the properties and businesses of policyholders to a wide range of risks, impacting markets and financial performance;
- according to studies cited by the ABI, approximately half of global GDP – USD 44 trillion – is highly to moderately dependent on nature;
- a link between physical and mental health of the human population and healthy ecosystems, impacting the business models of long-term savings providers, life and health insurers;
- the reputational risk of perceived inaction to prevent biodiversity and nature loss; and
- net zero transition cannot be achieved with new technologies alone, and nature plays an important part in decarbonization.

The Action on Nature Guide is intended to assist relevant firms with developing a strategy to take action to address biodiversity loss and as such, provides: tools and best practice examples for expertise and guidance from external organizations; information on developing a heatmap as an estimation of potential impacts; and best practice examples from first movers in the sector and information on setting up internal working groups within firms to agree on guiding principles.

The ABI is the latest sector-focused body to **turn its attention to the prevention of biodiversity loss** following the adoption of the Kunming-Montreal Global Diversity Framework (GBF) at COP15 in 2022. The GBF is an agreement among almost 200 countries to, among

other things, protect at least 30% of the planet's lands, inland waters, coastal areas and oceans by 2030.

The Action on Nature Guide has been produced as part of the ABI's umbrella action plan, the **Climate Change Roadmap**, which sets targets that the sector must meet by 2025 to keep it on track to halve emissions by 2030 and reach net zero by 2050.

Taking the Temperature: As observed by Goldman Sachs Asset Management in its 12th annual insurance survey, climate change considerations impact coverage decisions. Relatedly, in its staff paper on nature-related risks and impacts for insurance, the European Insurance and Occupational Pensions Authority postulated that insurers could help reduce nature-related impacts through underwriting activities while also mitigating risk to their investment portfolios.

Like many other industries, participants in the insurance sector have adopted differing stances in relation to climate change. Munch Re for example, the world's largest reinsurer and a founding member of the Net Zero Insurance Alliance (NZIA), announced earlier this year that it would cease investment in and exclusive coverage of contracts and projects related to new oil and gas. On the other hand, several insurers including Munich Re recently have withdrawn from the Alliance due to U.S.-based challenges to membership based on antitrust grounds. And, on May 15, 2023, twenty-three Republican state attorneys general sent a letter to members of the NZIA expressing "serious concerns" about whether the NZIA's requirements comply with federal and state laws, and demanding certain information.