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Republicans Unveil Bills Targeting ESG in Securities and Banking

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In late July 2023, House Republicans on the Financial Services Committee introduced four bills targeting various business and market activities that implicate environmental, social, and governance issues. **In a statement** announcing the proposals, the committee stated that "[t]hese measures represent the first step in Republican efforts to combat the ESG movement by restricting politically motivated, non-material disclosure mandates, reforming the proxy voting and shareholder proposal processes, increasing transparency for federal banking regulators, and limiting the Securities and Exchange Commission's (SEC) authority to regulate shareholder proposals."

GUARDRAIL Act (H.R. 4790): The proposed Guiding Uniform and Responsible Disclosure Requirements and Information Limits Act of 2023 appears to target, at least in part, the SEC's **proposed climate-related disclosure rule**.

- It would amend the Securities Exchange Act of 1934 (Exchange Act) by providing that "whenever pursuant to this title the Commission is engaged in rulemaking regarding disclosure obligations of issuers, the Commission shall expressly provide that an issuer is only required to disclose information in response to such disclosure obligations to the extent the issuer has determined that such information is material with respect to a voting or investment decision regarding the securities of such issuer."
- The Act, if passed, also would require the Commission to "maintain a list" on its website "that contains (A) each mandate under the Federal securities laws and regulations that requires the disclosure of non-material information; and (B) for each such disclosure mandate, an explanation of why the mandate is required."

- The bill would expressly eliminate issuer private liability for omissions involving non-material information.
- It also mandates the formation of a Public Company Advisory Committee, which would "provide the Commission with advice on its rules, regulations, and policies with regard to its mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation," although the Commission would not be bound to "agree or act upon" the Committee's findings or recommendations.
- Finally, the Act would require the SEC to assess and issue a report on the "detrimental impact" of the European Union's **Corporate Sustainability Reporting Directive (CSRD)** and **Corporate Sustainability Due Diligence Directive (CSDDD)** on U.S. companies, consumers, investors and economy.

Congressman Bill Huizenga, a sponsor of the GUARDRAIL Act, said that the GUARDRAIL Act "takes positive and deliberate steps to refocus the SEC on its core mission instead of pushing a political and social agenda."

Protecting Americans' Retirement Savings from Politics Act (H.R. 4767): This bill addresses certain aspects of shareholder proposals, proxy voting, and the registration of proxy advisory firms.

- With respect to shareholder proposals, the proposed Act provides that an issuer may exclude from company proxy materials a shareholder proposal whose subject matter "is environmental, social, or political (or a similar subject matter)" and, in contrast to current SEC guidance, "without regard to whether such shareholder proposal relates to a significant social policy issue."
- The bill also would require the SEC, every five years, to "conduct a comprehensive study and issue a report on shareholder proposals, proxy advisory firms, and the proxy process" in which it would address a laundry list of eleven topics. It would also require proxy advisory firms to be registered with the Commission.
- Significantly, the bill would preclude managers of passively managed investment funds from voting securities, other than on "routine matters," except in accordance with the voting instructions of the beneficial owner or the issuer. Otherwise, managers must abstain from voting.
- Next, taking a page from certain state laws, the bill would amend the Investment Advisors Act of 1940 by mandating that, in acting in the "best interest" of the customer, "the best interest of a customer shall be determined using pecuniary factors, which may not be subordinated to or limited by non-pecuniary factors, unless the customer provides informed consent, in writing, that such non-pecuniary factors be considered," but in that event that investment advisor must "disclose the expected pecuniary effects to the customer over a time period selected by the customer and not to exceed three years." Pecuniary factor is defined as "a factor that a fiduciary prudently determines is expected to have a material effect on the risk or return of an investment based on appropriate investment horizons."
- Finally, under the bill, the SEC would have to undertake a study "to determine the extent to which issuers of municipal securities . . . make disclosures to investors regarding climate

change and other environmental matters; and solicit public comment with respect to such study."

American FIRST Act (H.R. 4823): The American Financial Institution Regulator Sovereignty and Transparency Act would amend various federal banking laws to limit U.S. regulators' interactions with international organizations.

- The bill would provide that the Board of Governors of the Federal Reserve, the Comptroller of the Currency, the Board of Directors of the FDIC, the Board of the National Credit Union Administration, and the Director of the Federal Housing Finance Administration, "may not implement a non-binding recommendation made by the Chairperson of the Financial Stability Oversight Council or contained in an Executive Order unless" the applicable regulator "provides the Committee on Financial Services of the House of Representatives (House Committee) and the Committee on Banking, Housing, and Urban Affairs of the Senate (Senate Committee) with— (A) notice that the [regulator] intends to implement such recommendation; (B) a report containing the proposed implementation by the [regulator] and a justification for such implementation; and (C) upon request, not later than the end of the 120-day period beginning on the date of the notice under subparagraph (A), testimony on such proposed implementation."
- The bill also would preclude these regulators from implementing a "major covered rule" without first providing the House and Senate Committees with "testimony, and a detailed economic analysis with respect to the proposed or final rule, including projections of economic costs, sectoral effects, and effects on the availability of credit, the gross domestic product, and employment." Major covered rule is defined as a rule having an "effect, in the aggregate, on the economy of the United States of $10,000,000,000 or more during the 10-year period beginning on the date the rule takes effect; and that is intended to align or conform with a recommendation from a nongovernmental international organization (including the Financial Stability Board, the Bank for International Settlements, the Network of Central Banks and Supervisors for Greening the Financial System, and the Basel Committee on Banking Supervision)."
- Additionally, the bill would prohibit these regulators from meeting with or otherwise engaging "with a covered international organization on the topic of climate-related financial risk during a calendar year unless the Federal banking regulator has issued a report" to the House and Senate Committees containing, for the previous calendar year, a "complete description of the activities of the covered international organization in which the Federal banking regulator participates (including any task force, committee, or other organizational unit thereof); and a detailed accounting of the governmental and non-governmental funding sources of the covered international organization." "Covered international organization" is defined as the Financial Stability Board, the Network of Central Banks and Supervisors for Greening the Financial System, and the Basel Committee on Banking Supervision.
- Federal banking regulators also would be required to keep a "complete record" of all interactions with "non-governmental international organizations" and issue a related report annually to the House and Senate Committees.

Businesses Over Activists Act (H.R. 4655): This bill would preclude the SEC from compelling an issuer to include in company proxy materials "any shareholder proposal" or related

discussion of such a proposal.

While on its face the bill is not ESG focused, its sponsor, Congressman Ralph Norman, made that focus clear: "ESG is an evil pollutant that must be eradicated from corporations and businesses. Ultimately, the Businesses Over Activists Act would preserve the first amendment rights of corporations and impede economic damages stemming from the misuse of resources delegated to the management of these politicized proposals. The SEC should not and does not have the authority to compel companies to include ESG proposals."

Taking the Temperature: We have frequently discussed Republican-led anti-ESG initiatives at the state level in the U.S. Numerous Republican-controlled state legislatures have enacted laws mandating divestment of state funds from asset managers deemed to "boycott the energy industry" or restricting investment managers from casting proxy votes for the purpose of furthering "non-pecuniary interests." Republican governors of 19 states launched an alliance, led by Florida Governor Ron DeSantis, to "push back against President Biden's environmental, social, corporate governance (ESG) agenda that is destabilizing the American economy and the global financial system. In March 2023, 21 Republican Attorney Generals wrote a letter addressed to over 50 large U.S. asset managers citing "concerns about the ongoing agreements between asset managers to use Americans' savings to push political goals during the upcoming proxy season." Focused on industry climate collaborations such as the Net-Zero Asset Managers Initiative, the AGs stated their intent to "enforce [their] states' civil laws against unfair and deceptive acts and practices and state and federal civil laws prohibiting agreements to restrain competition."

The four bills discussed above reflect federal legislators' apparent interest in increasing anti-ESG pressure. Even prior to the introduction of these bills, in June, two Republican members of Congress reintroduced the Ensuring Sound Guidance (ESG) Act, which would amend the Investment Advisers Act of 1940 and the Employee Retirement Income Security Act of 1974 (ERISA) by requiring managers to only consider "pecuniary factors" in acting in the best interests of clients unless the client specifically requests that non-pecuniary factors be considered. The bill challenges a Biden Administration Department of Labor rule that overturned previous restrictions on the ability of retirement plan fiduciaries to consider ESG-related factors in their investment decisions.

It is unclear whether any of the four House bills introduced in July will ever become law, or if they do, in a form remotely resembling the current text of the bills. The two paragraph Business Over Activists Act does not appear to represent a meaningful attempt at legislation in its outright ban on inclusion of shareholders proposals in company proxy materials. The Securities Exchange Act Rule 14a-8, which governs this issue, was first adopted over 80 years ago, in 1942, and is an established part of the corporate governance framework in the U.S.

As for the other bills, we offer the following observations:

- **The Guardrail Act's mandate that only material information needs to be disclosed appears to reflect a view that elements of the SEC's climate disclosure rule (and perhaps other regulations previously issued by the Commission) would require disclosure of non-material information. This provision thereby offers an issuer the**

ability to argue that at least in certain instances non-compliance would not be a violation of the regulation (which in any event still has not been finalized). Similarly, the requirement that the SEC maintain a list of required non-material disclosures presumes that certain mandated disclosure is immaterial and appears at least in part to be an effort to initiate a public debate and open for legal challenge the SEC's justification for its assessment of whether required disclosure is material or, if not, why disclosure if warranted.

- The Guardrail Act's requirement that the SEC issue a report on the "detrimental impact" of the EU's CSRD and CSDDD seems to put the rabbit in the hat by demanding a certain conclusion. The CSRD aims to update the existing EU sustainability reporting framework and expand the number of companies required to report on sustainability-related impacts, opportunities and risks. The CSDDD requires in-scope companies to assess and take action with respect to environmental harm and human rights concerns throughout their value chains. However, we often have discussed the desirability of attempting to achieve something resembling global consensus regarding sustainability-related disclosure, particularly for multi-national companies, rather than requiring companies operating in multiple jurisdictions to satisfy disparate disclosure regimes. To the extent sustainability issues raise material risks or opportunities for companies, disclosure likely is required irrespective of a regulatory mandate, underscoring the potential value of initiatives like the CSRD. Similarly, the CSDDD can be viewed, in part, as establishing a governance framework for assessing sustainability-related risks and opportunities, and therefore, supports the processes and practices underlying the disclosure required by the CSRD.

- The Protecting Americans' Retirement Savings from Politics Act would overturn certain current SEC guidance on when issuers must include shareholder proposals in company proxy materials. The bill would permit exclusion of all ESG-related proposals, and would not require proposals addressing a "significant social policy" issue to be included. Currently, pursuant to Staff Legal Bulletin 14L issued in 2021 from the Division of Corporation Finance, companies may not exclude shareholder proposals under the "ordinary business operations" exemption if they implicate a "significant social policy," irrespective of the significance of that policy to the company and even if the impact falls below the economic thresholds of Rule 14a-8(i)(5) (a separate basis for exclusion).

- The proposed Act's prohibition on proxy voting by investment managers is potentially significant, and echoes criticism from other quarters about the influence of passive managers on corporate voting. In a March 30, 2023 letter to over 50 large asset managers on behalf of 21 Republican state attorneys general, the AGs stated that "your non-ESG funds do not disclose to investors that their investments will be used to further ESG goals, including pressuring companies to reduce emissions in economically destructive ways." Relatedly, the letter adds that, "[i]nvestors looking for low cost, passive indexing investments may be unwittingly funding . . . ESG activism." We also discussed that, at the end of last year, Vanguard withdrew from the Net Zero Asset Managers initiative following a report by the Minority Staff of the U.S. Senate Committee on Banking, Housing and Urban Affairs regarding the influence of the "liberal views" toward ESG of the "Big Three" asset managers, Blackrock, State Street and Vanguard. The report asserted that, contrary to what it deemed appropriate

for passive investment strategies such as index funds, asset managers that are NZAM members commit to engage with portfolio companies toward a goal of achieving net zero emissions by 2050. The report recommended, among other things, increased disclosure in the form of more limited availability of Schedule 13G passive ownership reporting, and consideration of whether any of these managers could be deemed a bank holding company, and therefore subject to Federal Reserve regulation along with capital and liquidity requirements, to the extent that they "influenced at least one of the banking organizations in its respective investment funds to conform its lending activities to ESG principles or otherwise change corporate policies."

- **The House bill, consistent with the Republican AGs' letter and the Senate Banking Minority Staff report, questions whether the definition of passive investing is limited in scope to an actual investing strategy, but instead also requires that passive managers not engage with portfolio companies on climate or other stewardship issues. Were such a view to become the consensus, it would have enormous implications for the ability of the passive asset management industry to engage with portfolio companies. PricewaterhouseCoopers, for instance, estimates that passive investment strategies will represent 25% of global assets under management by 2025, for a total of $36.6 trillion AuM. The inability of passive asset managers to engage with companies in which their clients have invested such large amounts inevitably would radically change the landscape of investor-company engagement and have particularly substantial ramifications in the climate change area, where asset managers have been vocal advocates for greater climate-related disclosure and consideration by company boards of climate risks and opportunities.**
- **Finally, the American FIRST Act targets, among other things, U.S. banking regulator interaction with international banking and financial organizations, often directly taking aim at those involved in addressing issues arising from climate change. The bill would preclude (absent notice and the required report to Congress) these regulators from "meeting with or otherwise engaging with," or implementing rules that are "intended to align or conform with a recommendation from a nongovernmental international organization (including the Financial Stability Board, the Bank for International Settlements, the Network of Central Banks and Supervisors for Greening the Financial System, and the Basel Committee on Banking Supervision)."**
- **The Financial Stability Board, an international body convened by the G20 nations to monitor and make recommendations about the global financial system, formed the Task Force on Climate-Related Financial Disclosures to give guidance on climate-related financial disclosure. The TCFD disclosure framework is one of the most influential reporting standards (if not the most) as numerous regulators and large institutional asset managers have coalesced around its recommendations as the appropriate basis for issuer disclosure. However, following the publication of the inaugural International Sustainability Standard Board (ISSB) Standards—IFRS S1 and IFRS S2, which "fully incorporate the recommendations of the TCFD"—the Financial Stability Board asked the IFRS Foundation to take over the monitoring of the progress on companies' climate-related disclosures from the TCFD. Presumably the bill would apply to regulator interactions with the ISSB.**

- **Likewise, the Basel Committee has been significantly involved in climate-related financial system matters, as we have discussed, for example, here and here.**
- **Similarly, the purpose of the Network of Central Banks and Supervisors for Greening the Financial System is to "help strengthening the global response required to meet the goals of the Paris agreement and to enhance the role of the financial system to manage risks and to mobilize capital for green and low-carbon investments in the broader context of environmentally sustainable development. To this end, the Network defines and promotes best practices to be implemented within and outside of the Membership of the NGFS and conducts or commissions analytical work on green finance."**