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U.S. investments in ESG to continue despite political pushback, experts say

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While congressional Republicans continue to push anti-ESG legislation forward — with the most recent package of bills advanced focused on ERISA-governed retirement plans — industry experts say U.S. fiduciaries are still investing with environmental, social, and governance factors in mind.

"I think plan administrators are aware that the policy pendulum hasn't stopped swinging," said Bryan McGannon, managing director of US SIF: The Sustainable Investment Forum, a nonprofit organization whose members represent $5 trillion in assets under management.

"The demand from plan participants for sustainable options is far outweighing any future fear from policy changes," he added.

On Sept. 14, the House Education and Workforce Committee advanced a package of four GOP-led bills out of committee, with each bill amending the Employee Retirement Income Security Act of 1974 in different ways.

Reps. Rick W. Allen, R-Ga.; Erin Houchin, R-Ind.; Jim Banks, R-Ind.; and Bob Good, R-Va., who chairs the Health, Employment, Labor and Pensions Subcommittee, introduced the bills with the aim of ERISA-governed plans focusing on maximizing returns "rather than on woke environmental, social and corporate governance (ESG) factors," the lawmakers said in a Sept. 6 committee news release.

"It's important to protect workers' retirement accounts from being weaponized by political movements," Committee Chair Virginia Foxx, R-N.C., said at the committee markup Sept. 14.

Allen's bill would require that ERISA fiduciaries only consider pecuniary factors in investment decisions; Houchin's bill would require ERISA plans' proxies be voted in the economic interest of a plan; Good's bill would ban plans from considering race, religion, sex or national origin in selecting a fiduciary, counsel, employee or service provider; and Banks' bill would require that plans notify participants on the difference between choosing investments selected by fiduciaries and choosing investments through a brokerage window.

While the bills could pass before the full House, McGannon said there's "very little" chance that the Democratic-controlled Senate will even consider them, calling them "messaging bills."

Ultimately, sources agreed that investor demand will outweigh anti-ESG messaging, and plan fiduciaries will continue to make ESG-related investments.

"Our key takeaway, (and) what we're seeing from our members and from the marketplace, is that the consumer demand for sustainable offerings in retirement plans is the leading factor of where the retirement space is going," McGannon said.

Changing the conversation

Though the bills will not affect the practice of ESG investing, some believe the rhetoric of such anti-ESG legislation is impacting how investors talk about it.

"This is not impacting what people are doing in a sense that companies are still moving forward with their capital plans (and) with their investments," said Steven M. Rothstein, managing director of the Ceres Accelerator for Sustainable Capital Markets. "It is having an impact, in the short term, on what people are saying."

Greg Hershman, head of U.S. policy at the United Nations-backed Principles for Responsible Investment, had a similar view.

Based on conversations with PRI signatories over the past 18 months, Hershman said asset owners, investment managers and service providers are focusing more on how they talk about ESG investing.

The focus on messaging may mean convening companies' compliance teams and marketing teams more closely and more often, "but the fundamentals of their financial analysis, the products that they're selling or the products that they're getting rid of — none of that is changing," he said.

"The investor demand for sustainable products (and) ESG-aligned products is still continuing to grow, and so they're just responding to that market demand," Hershman added.

Michelle Dunstan, chief responsibility officer at Janus Henderson Investors, said that more discussions about ESG may actually be beneficial, as they raise the profile of ESG in the public sphere.

"Where there are financially material ESG considerations, we view it as entirely consistent with our fiduciary duty to treat them the same we do any financially material factor — by incorporating it into each appropriate stage of our investment management process," said Dunstan, who oversees the firm's ESG strategies. Janus Henderson had $322.1 billion in assets under management as of June 30.

The evolution of ESG is a "journey," she said, and as time passes and more people engage with each other over the topic, the investment community will have more "clarity about what ESG integration is and why incorporating financially material ESG considerations help enhance financial outcomes for our clients."

Pushback to continue

For now, Republicans continue to introduce legislation — both on the federal and state levels — that takes aim at ESG investing.

"These bills didn't surprise me," Hershman said, and he expects to see more anti-ESG legislation introduced soon.

Similarly, Reps. Sean Casten, D-Ill., and Juan Vargas, D-Calif., who co-chair the Congressional Sustainable Investment Caucus, said in a Sept. 14 news release, "We are once again disappointed, but not surprised, by House Republicans' ongoing attacks on investor freedom and the free market."

"Republicans seek to make harmful and unnecessary changes to ERISA that completely undermines worker's retirement security by forcing fiduciaries to ignore financial risks and limiting their ability to act in the best interests of those who have entrusted them with their money," the lawmakers said. "We urge our Republican colleagues to come to their senses and end this assault on Americans' retirement savings and pensions."

In a Sept. 14 news release, US SIF's McGannon specifically called out the use of the "pecuniary/non-pecuniary" framework in the package of bills.

"Our members find the pecuniary vs. non-pecuniary rules to be vague and not well-suited to the realities of the investment industry," he said in the news release. "ESG data can be material to the risk and/or return of an investment."

The pecuniary vs. non-pecuniary language dates back to a Labor Department rule, promulgated under the Trump administration, that said fiduciaries could not invest in "non-pecuniary" vehicles that sacrifice investment returns or take on additional risk.

That has since been reversed by a new DOL rule issued in November, allowing fiduciaries to consider climate change and ESG factors when selecting investments and exercising shareholder rights. Labor Department officials have said the Trump-era rule created a "chilling effect" on considering ESG factors, and their aim with the new rule was to restore neutrality.

Republicans have attacked the Biden administration's rule via bills, lawsuits, and a joint resolution under the Congressional Review Act to overturn it, which President Joe Biden blocked by using his first veto.

On the state level, Republican officials also continue to propose and pass legislation restricting investing in ESG-themed strategies.

In late June, GOP lawmakers in North Carolina overrode the governor's veto to enact a law that bars state entities from considering ESG criteria in investment and employment decisions.

"Around the world, we're not seeing anything like this anti-ESG backlash in other places," PRI's Hershman said, acknowledging that while there's some pushback in Europe, it's primarily over implementation of ESG regulations that have been proposed for years.

And while other countries move "full steam ahead with responsible investment," there is the possibility that U.S. investors become frustrated by the barriers that other markets don't have, he said.

"What would be sad is if we get to a place where investors are saying, 'there's better information in other countries,' and that will affect their investment decisions," Rothstein said, specifically referring to climate disclosure regulations.

Ultimately, investors will be making the final call, Hershman said.

"Everything that we hear from the actual investors, from the market, from the demand for these products is that the (anti-ESG) rhetoric is not reflecting the reality in the markets and on the ground," Hershman said.

"My expectation is that the market demand is going to prevail in the end," he added.

Palash Ghosh contributed to this story.