Written Statement of

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Examining Environmental and Social Policy in Financial Regulation

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Chairman McHenry, Members of the Committee, thank you for the opportunity to submit this written statement for your consideration in connection with the July 12, 2023, House Financial Services Committee Hearing entitled “Protecting Investor Interests: Examining Environmental and Social Policy in Financial Regulation.” By way of quick background, I was a tenured professor at the Harvard Business School. Upon my retirement, I became a Visiting Professor of Management Practice at the Saïd Business School at the University of Oxford. I was the Founding Chairman of the U.S. NGO, the Sustainability Accounting Standards Board (SASB), now part of the International Sustainability Standards Board (ISSB). I have been studying and advocating for over 30 years that investors should be provided with financially relevant information on environmental, social, and governance performance according to a set of standards, just as they currently have for financial performance thanks to financial accounting standards.[1] This will enable both investors and companies make better capital allocation decisions for maximizing their returns.

The Securities and Exchange Commission (SEC) has a threefold mission: (1) protecting investors, (2) facilitating capital formation, and (3) maintaining fair, orderly, and efficient markets. Central to all three is that companies provide information on financially material risk and opportunities to their investors.[2] This is specifically noted with respect to protecting investors, saying: “public companies, fund and asset managers, investment professionals, and other market participants to regularly disclose significant financial and other information so investors have the timely, accurate, and complete information they need to make confident and informed decisions about when or where to invest.”[3]

I will argue that disclosure by companies of material ESG factors according to a set of standards is essential for investor protection. But first, it is necessary to distinguish between *values*-based investing, which is not based on financial materiality, and *value*-based investing, which is. Material ESG risk factors are pecuniary and fiduciary duty requires that these be taken into account. Through engagement with their shareholders, companies must then determine which ESG factors are material, and these vary by industry. The SASB/ISSB provides useful guidance here.

Climate change is an existential challenge to America’s future prosperity and security. While it is typically portrayed in the media and in political messaging as a largely liberal priority, the challenges it presents are recognized by conservative executives, conservative politicians, conservative NGOs, conservative investors, and fossil fuel companies alike. The SEC has the statutory authority to issue a rule on climate risk disclosure, as the issue is material to investors, although I will detail some suggestions for how the rule can be simplified and improved so as not to exceed the SEC’s statutory authority.

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[1] https://www.forbes.com/sites/bobeccles/2021/01/06/2020-the-year-the-narrative-changed-for-sustainability-reporting/?sh=667ab3e1394b, accessed July 3, 2023.
[2] https://www.sec.gov/about/what-we-do#section2, accessed July 7, 2023.
[3] https://www.sec.gov/about/what-we-do#section1, accessed July 7, 2023.

Values-based Investing

It is important to draw a distinction between value-based investing and values-based investing. I have written about the difference with Professor Jill Fisch of the University of Pennsylvania Carey Law School.[4] Value-based investing is focused on maximizing risk-adjusted returns, using ESG factors to the extent they contribute to this. Values-based investing gives investors the opportunity to invest according to their own values. Doing so may hurt returns due to a lack of diversification, for example by excluding fossil fuel or Chinese companies.

Values can be defined along many dimensions, such as political or religious. An example of the former is the "Point Bridge America First ETF" (MAGA).[5] It defines itself as an example of "Politically Responsible Investing®" and explains "The innovative strategy behind the MAGA ETF that allows you to invest in companies that align with your Republican political beliefs. The MAGA Index is made up of 150 companies from the S&P 500 Index whose employees and political action committees (PACs) are highly supportive of Republican candidates." Another example is the American Conservative Values ETF (ACVF).[6] Liberal funds include the Democratic Large-Cap Core Fund (DEMZ).[7]

All of these values-based investing strategies are based on exclusion and face the challenge of matching market returns due to lack of diversification, although the typical claim is that this exclusion actually helps returns. Similar arguments are made regarding exclusion or inclusion of fossil fuel companies. Those in support of each strategy provide evidence to support their thesis and those in support of the other provide contrary evidence, along with evidence in favor of their strategy. The fact that contrary findings often exist is due to differences in the time periods selected for the study, the companies that comprise the sample, and the empirical methodologies that are used.

A religious example of values-based investing is the "S&P 500 Catholic Values ETF" (CATH).[8] "CATH excludes companies involved in activities perceived to be inconsistent with Catholic values as set out by the U.S. Conference of Catholic Bishops, including screens for weaponry and child labor." The fund's Fact Sheet state that "CATH's consideration of the Guidelines in its investment process may result in choices not to purchase, or sell, otherwise profitable investments in companies that have been identified as being in conflict with the Guidelines. This

[4] "The Politics of Values-Based Investing" by Robert G. Eccles and Jill E. Fisch, *Harvard Law School Forum on Corporate Governance*, September 7, 2022, https://corpgov.law.harvard.edu/2022/09/07/the-politics-of-values-based-investing/, accessed July 1, 2023.

[5] https://www.pointbridgecapital.com/etf/, accessed July 1, 2023.

[6] https://acvetfs.com/, accessed July 1, 2023. "Simply put, we seek to exclude as many companies hostile to conservative values as possible without sacrificing performance."

[7] https://demz.fund/, accessed July 1, 2023. "It's a fund that is designed to provide similar risk and performance as the S&P 500, but it only includes companies that have made over 75% of their political contributions to Democratic causes and candidates." It is also a fossil-free fund.

[8] https://www.globalxetfs.com/funds/cath/, accessed July 1, 2023

means that the Fund may underperform other similar funds that do not consider the Guidelines when making investment decisions."[9]

Investors should have the freedom to invest in values-based funds as long as it is clear how the portfolio of the fund is constructed. Protecting investors who choose to invest in such funds requires a clear articulation of the values-based proposition for constructing it, the methodology for selecting portfolio companies, disclosure of the companies within the portfolio, methodologies for determining if a company no longer fits the values-based proposition, and either the disclosure that the fund may underperform the market due to a lack of diversification or an argument why this will not be the case. Investors can then decide for themselves whether they want to invest in such a fund or not.

Value-based Investing

In contrast, values do not factor into value-based investing. Since the goal is to maximize risk-adjusted returns, broad screens are not used—whether these are based on political or religious values, or sectors such as oil and gas and "sin stocks" like adult entertainment, alcohol, gaming, tobacco, and weapons. The focus of this Hearing is on value-based investing, and this is where ESG considerations come into play.

Unfortunately, some have confused the use of financially-material ESG performance information with values-based investing. This is the basis for much of the controversy that exists today, compounded by the confusion created by so-called ESG funds that are simply based on negative screening. Taking account of financially-material ESG factors that matter to risk and return is no different from other risk factors such as liquidity risk, interest rate risk, brand equity risk, and political risk. In truth, there is no need for the term "ESG investing." More useful would be to distinguish between value-based investing and values-based investing.

The value relevance of financially materially ESG factors has been recognized by a number of prominent conservatives. In a piece for the *Harvard Business Review*, "Rescuing ESG from the Culture Wars," Dan Crowley, a life-long Republican and partner at K&L Gates, and I noted that "ESG is simply about identifying material risk factors that matter to company profitability and shareholder value over time."[10] In terms of the current ESG Culture Wars, we argue that to resolve them in a bipartisan fashion, "The key will be returning ESG to its original and narrow intention — as a means for helping companies identify and communicate to investors the *material* long-term risks they face from ESG-related issues."

Eli Lehrer, co-founder and President of the center-right R Street Institute has observed that "At the end of the day, the market wants to incorporate externalities that have an impact on profit and loss. The government shouldn't forbid investors and investment managers from using a broad array of information including information about things like climate change impacts and

[9] https://go.globalxetfs.com/l/750543/2021-07-28/lsw3r, accessed July 1, 2023.
[10] https://hbr.org/2023/02/rescuing-esg-from-the-culture-wars, accessed July 2, 2023

workforce diversity. But this information has to be considered in the context of business—not the context of moral values alone."[11] In a joint piece for the *Harvard Law School Forum on Corporate Governance*, "It's Time to Call a Truce in the Red State/Blue State ESG Culture War," we state that "any number of ESG-related considerations can have strong connections to investment return."[12] We also state that "even though most pro- *and* anti-state level ESG policies don't work as advertised, it's unwise to dismiss the rationale behind them out of hand. State employees–who, ideally, will represent the full spectrum of a state's views–shouldn't have their pension funds invested in ways that place what may be political views above return on investments."

Nick Loris of the "Conservative Coalition for Climate Solutions" has expressed a similar view saying that "If ESG factors are material to public or private asset management, firms should be able to consider them." He also notes that lawmakers should "refrain from ESG or anti-ESG policies" that will interfere with the ability of asset managers to focus on pecuniary factors in the exercise of their fiduciary duty.[13]

The foundation for investor protection in ESG integration is that investors have relevant and reliable information on the material ESG factors that matter to value creation. The lack of standards here has been a major barrier.[14] Just as we have standards for financial reporting, we need standards for investor-relevant sustainability reporting. The language that has emerged for this is "single materiality." That was the focus of SASB and is the focus of the ISSB. In contrast, the standards developed under the European Union's "Corporate Sustainability Reporting Directive" (CSRD) are so-called "double materiality" since they are intended for other stakeholders as well.

The fact that ESG performance can represent material risks in value-based investing is clear from examining four examples that have been identified as "anti-ESG": (1) changes to ERISA in the Trump administration, (2) Florida House Bill 3, (3) ALEC's model legislation, and (4) H.R. 7151-Ensuring Sound Guidance (ESG) Act, introduced by Rep. Andy Barr (KY). I will examine each of these examples in greater detail below.

The ERISA Rule

Tim Boyle of the Bipartisan Policy Center and I have written about the how the issue of ESG in the Employment Retirement Security Act of 1970 (ERISA) has changed from one administration

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[11] https://interviews.robertеccles.com/an-interview-with-eli-lehrer-of-the-r-street-institute-part-i/, accessed July 2, 2023

[12] https://corpgov.law.harvard.edu/2023/05/29/its-time-to-call-a-truce-in-the-red-state-blue-state-esg-culture-war/, accessed July 2, 2023

[13] https://www.c3solutions.org/policy-paper/a-free-enterprise-approach-to-esg-maximizing-investor-returns-for-the-benefit-of-people-and-the-planet/, accessed July 2, 2023.

[14] https://www.forbes.com/sites/bobeccles/2021/01/06/2020-the-year-the-narrative-changed-for-sustainability-reporting/?sh=7f3e8871394b, accessed July 7, 2023.

to the next.[15] During the Trump administration, after receiving input during the rulemaking process, the Department of Labor (DOL) removed any mention of ESG in the final rule “"Financial Factors in Selecting Plan Investments" (“Rule”)[16] to depoliticize it. In turn, it required fiduciaries to only focus on “pecuniary” issues, which were defined as those that have a “material effect on the risk and/or return of an investment based on appropriate investment time horizons” consistent with the plan. There was virtually no language saying that ESG factors cannot be material and thus cannot be considered.

In 2022, the Biden administration issued amendments which removed the terms “material” and “pecuniary” from the 2020 Rule and instead required that fiduciaries should focus on “relevant risk and return factors that *may* [emphasis mine] include the economic effects of climate change and ESG.” Whether there is a substantive difference in the language very much lies in the eyes of the beholder. Material ESG factors are indeed pecuniary and relevant to risk and return. And just as the Rule in the Trump administration did not explicitly preclude the use of ESG factors, the amendments in the Biden administration do not require them. A fiduciary’s duty requires that they “not subordinate the interests of participants and beneficiaries (such as by sacrificing investment returns or taking on additional investment risk) to objectives unrelated” to the plan.

Doyle and I point out that the change in language is small in comparison to the political reaction. We conclude that “If the purpose of ERISA is to protect retirement savings, both sides of the aisle should focus on the duties of loyalty and prudence owed to beneficiaries and plan participants, and less on an Administration’s policy agenda. Ironically, this is what ERISA was originally intended to protect against.”

Florida House Bill 3

On May 2, 2023, Governor Ron DeSantis signed into law Florida House Bill 3 (HB 3)[17] “An act relating to government and corporate activism.” The press release[18] stated, “Today, Governor Ron DeSantis signed comprehensive legislation to protect Floridians from the corporatist environmental, social, and corporate governance (ESG) movement — a worldwide effort to inject woke political ideology across the financial sector, placing politics above the fiduciary duty to make the best financial decisions for beneficiaries.” Leah Malone and Emily B. Holland of the law firm Simpson Thatcher and Bartlett wrote in the *Harvard Law School Forum on Corporate Governance* that “Florida Passes Farthest-Reaching Anti-ESG Bill to Date.”[19]

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[15] https://www.realclearenergy.org/articles/2023/05/09/its_time_to_take_the_unnecessary_politics_out_of_esg_and_retirement_savings_898242.html, accessed July 2, 2023
[16] https://www.govinfo.gov/app/details/FR-2020-11-13/2020-24515, accessed July 7, 2023.
[17] https://www.flsenate.gov/Session/Bill/2023/3, accessed July 10, 2023
[18] https://www.flgov.com/2023/05/02/governor-ron-desantis-signs-legislation-to-protect-floridians-financial-future-economic-liberty/, accessed July 20, 2023
[19] https://corpgov.law.harvard.edu/2023/05/27/florida-passes-farthest-reaching-anti-esg-law-to-date/?utm_content=buffercb737&utm_medium=social&utm_source=linkedin.com&utm_campaign=buffer, accessed July 2, 2023.

However, a careful reading of the bill makes clear that it does not preclude the use of material ESG factors.[20] The essence of the bill is:

"Section 1. Subsection (1) of section 17.57, Florida 180 Statutes, is amended to read:

17.57 Deposits and investments of state money.—

(1) (a) As used in this subsection, the term 'pecuniary factor' means a factor that the Chief Financial Officer, or other party authorized to invest on his or her behalf, prudently determines is expected to have a material effect on the risk or returns of an investment based on appropriate investment horizons consistent with applicable investment objectives and funding policy. The term does not include the consideration of the furtherance of any social, political, or ideological interests." (p. 8)

Like the ERISA Rule in the Trump administration, the bill does not contain any language explicitly ruling out ESG considerations. If they are pecuniary, which they can be but not always are—and this depends on materiality—they can be included. This is value-based investing. The clause about not including "the consideration of the furtherance of any social, political, or ideological interests" is to prohibit values-based investing, and applies whether the values are liberal or conservative.

ALEC Model Legislation

The American Legislative Exchange Council (ALEC) has introduced the "State Government Employee Retirement Protection Act" model legislation.[21] This model legislation "strengthens fiduciary rules to protect pensioners from politically driven investment strategies. These strategies reduce investment returns over the long term which leads to underfunding in state pension plans across the country." As Florida HB 3 notes, politically driven investment strategies are inappropriate in value-based investing, which is the basis for state employee retirement pension funds.

Definition "c" states that, "When used to qualify a risk or return, the term 'material' means a risk or return regarding which there is a substantial likelihood that a reasonable investor would attach importance" when "evaluating the potential financial return and financial risks of an existing or prospective investment." Definition "d" defines pecuniary factors as those having "a material effect on the financial risk and/or financial return of an investment." Here again, there is an emphasis on the concept of "materiality" for defining what is pecuniary.

The model legislation does not preclude any use of ESG factors but states, appropriately, that

[20] https://www.forbes.com/sites/bobeccles/2023/05/29/floridas-anti-esg-house-bill-3-is-a-sheep-in-wolfs-clothing/?sh=5c9c3504c8b8, accessed July 2, 2023.
[21] https://alec.org/model-policy/state-government-employee-retirement-protection-act/, accessed July 2, 2023

they should be considered "only if they present economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories."

The "Ensuring Sound Guidance (ESG) Act" (H.R. 7151)

Congressman Andy Barr (R-KY) has introduced H.R. 7151-Ensuring Sound Guidance (ESG) Act.[22] The purpose of the bill is "To amend the Investment Advisers Act of 1940 and the Employment Retirement Income Security Act of 1974 to specify that only pecuniary factors are to be taken into account in determining best interest, and for other purposes." The essence of the bill is:

"SEC. 2. INVESTMENT ADVISORS ACT OF 1940 AMENDMENT.

(a) In General.—Section 211(g) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–11(g)) is amended by adding at the end the following:

(3) BEST INTEREST BASED ON PECUNIARY FACTORS.—For purposes of paragraph (1), the best interest of a customer shall be determined using only pecuniary factors, unless the customer specifically requests that non-pecuniary factors be considered."

The bill clearly distinguishes between values-based and value-based investing since it allows for values-based investing using non-pecuniary factors but only based on a customer's specific requests. Sec. 3 further explains that "The fiduciary may not subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to other objectives and may not sacrifice investment return or take on additional investment risk to promote non-pecuniary benefits or goals." Again, this is absolutely appropriate for value-based investing.

Like Florida HB 3 and the ALEC model legislation, the bill does not have a blanket exclusion on the use of ESG factors. Rather, Sec. 4 states that it "would prevent such pension plans from subordinating the interests of participants and beneficiaries to environmental, social, or governance objectives." In other words, while ESG factors cannot be used for values-based investing, there is nothing in this bill that prevents their use for value-based investing when they are pecuniary, which is the case when an ESG factor is material in terms of value creation.

Materiality

The importance of materiality in considering ESG factors in value-based investing is the essence of S. 5005, the "Mandatory Materiality Requirement Act of 2022," which was introduced by Senator Mike Rounds (R-SD) and seven other senators in September 2022.[23] Companion legislation, H.R. 9408, was introduced by Congressmen Bill Huizenga (R-MI) and Andy Barr (R-

[22] H.R.7151-Ensuring Sound Guidance Act, accessed July 2, 2023.
[23] https://www.congress.gov/bill/117th-congress/senate-bill/5005/all-info, accessed July 2, 2023.

KY) in December 2022.[24] The purpose of the bill is "To amend the Securities Act of 1933 to require that information required to be disclosed to the Securities and Exchange Commission by issuers be material to investors of those issuers, and for other purposes." It proposes to change some language in Section 2(b) of "Securities Act of 1933" to read:

"Whenever pursuant to this title of the Commission is engaged in rulemaking regarding disclosure obligations of issuers, the Commission may impose a disclosure requirement on an issuer only if the Commission expressly determines that there is a substantial likelihood that a reasonable investor of the issuer would consider the information disclosed to the Commission under the requirement to important with respect to an investment decision regarding the issuer."

The bill further explains that "information is important with respect to an investment decision made by the investor if there is a substantial likelihood that the investor would view the failure to disclose that information as having significantly altered the total mix of information made available to the investor."

ESG disclosures by U.S. companies are now common. A study by Governance & Accountability Institute, Inc. found that 96% of the S&P 500 and 81% of the Russell 1000 are voluntarily producing sustainability reports, typically having separate sections on Environmental, Social, and Governance.[25] In their Working Paper "The Political Polarization of Corporate America" Professors Vyacheslav Fos of Boston College, Elisabeth Kempf of Harvard Business School, and Margarita Tsoutsoura of Washington University in St. Louis found that 69% of the top five executives in the S&P 1500 are Republican, a fairly constant number over the past 10 years.[26] All of the top 10 holdings as of July 1, 2023 in MAGA ETF (Eli Lily and Co., Copart Inc., Pulte Group Inc., Verisk Analytics Inc., Molson Coors Beverage Co, Martin Marietta Materials, Carnival Corp, Cardinal Health Inc, Vulcan Materials Co. and the Cooper Companies Inc) published sustainability reports.[27] The same is true[28] for the top 10 holdings in Strive Asset Management's "Strive U.S. Energy ETF" (DRLL).[29] Its top holding is ExxonMobil. The major sections on the

[24] https://www.congress.gov/bill/117th-congress/house-bill/9408/text?s=1&r=54, accessed July 2, 2023.
[25] https://www.ga-institute.com/research/ga-research-directory/sustainability-reporting-trends/2022-sustainability-reporting-in-focus.html, accessed July 2, 2023.
[26] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3784969, accessed July 3, 2023.
[27] https://www.esg.lilly.com/?redirect-referrer=https%3A%2F%2Fwww.google.com%2F, https://www.copart.com/content/copart-esg-report-2022.pdf, https://pultegroupcares.com/sustainability/2021-report/, https://www.verisk.com/csr/esg-resource-library/, https://www.verisk.com/csr/esg-resource-library/, https://www.molsoncoors.com/sites/molsonco/files/Molson_Coors_ESG_AW6_V7_0.pdf, https://mcdn.martinmarietta.com/assets/sustainability/flip/sustainability2021-e/index.html, https://carnivalsustainability.com/, CardinalHealth.com/ESGReport., https://csr.vulcanmaterials.com/, https://www.coopercos.com/esg/
[28] https://www.forbes.com/sites/bobeccles/2022/08/26/drilling-into-drlls-top-10-holdings-a-woke-analysis/?sh=67d0dde9307a, accessed July 2, 2023.
[29] https://www.strivefunds.com/drll, accessed July 23, 2023.

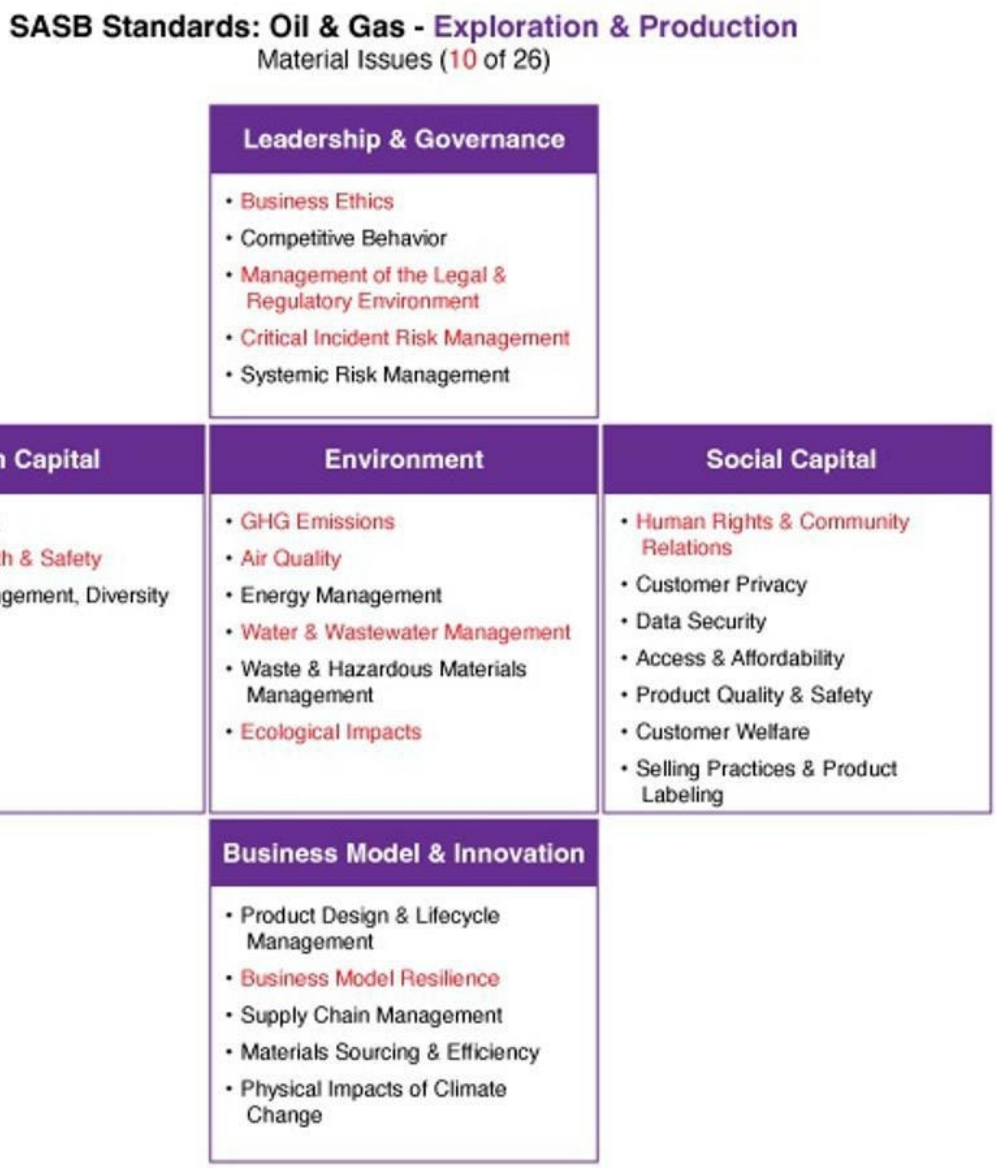
company's Sustainability web page are Environmental, Social, and Governance, i.e., ESG[30] and its "Sustainability Report" published in December 2022 provides performance information organized the same way.[31]

When it comes to ESG disclosures, the challenge is in separating those factors relevant to value-based investing, which is the focus of "The Mandatory Materiality Requirement Act," vs. values-based investing. A further challenge, as Crowley and I have pointed out, is that "The problem with these reports is that, in contrast to financial reporting, they are not based on a set of standards. This makes it difficult for investors to assess their validity and compare performance across different companies."[32] Further complicating the issue for investors is that these reports typically do not distinguish between financially-material ESG information and ESG information for other stakeholders. This makes it difficult and time consuming for investors to find the information that is relevant to them.

The work of the U.S. NGO "Sustainability Accounting Standards Board" (SASB)[33], now part of the International Sustainability Standards Board (ISSB)[34], can be quite helpful if this bill is passed. The SASB website explains that "the SASB Standards identify the sustainability-related risks and opportunities most likely to affect an entity's cash flows, access to finance and cost of capital over the short, medium or long term and the disclosure topics and metrics that are most likely to be useful to investors."[35]) With the input of companies, investors, NGOs, and industry experts, SASB has developed guidance on the financially relevant material ESG issues for 77 industries organized in terms of 11 sectors. There are 26 categories organized in terms of environment, social capital, human capital, business model & innovation, and leadership & governance. SASB has developed a "Materiality Finder" which enables anyone to identify what it considers to be the material issues for any listed company.[36] The work of SASB is at the core of the ISSB which currently has a consultation on how these standards can be adapted for international use.[37]

This can be illustrated using the example of ExxonMobil. It is classified as Oil & Gas Exploration and the diagram below shows the material issues for this industry:

[30] https://corporate.exxonmobil.com/news/reporting-and-publications/sustainability-report#Sustainabilityinaction, accessed July 2, 2023.
[31] https://corporate.exxonmobil.com/-/media/global/files/sustainability-report/publication/exxonmobil-sustainability-report.pdf, accessed July 2, 2023.
[32] Op. Cit.
[33] https://www.sasb.org/, accessed July 2, 2023.
[34] https://www.ifrs.org/groups/international-sustainability-standards-board/, accessed July 2, 2023.
[35] https://sasb.org/about/, accessed July 7, 2023.
[36] https://www.sasb.org/standards/materiality-finder/?lang=en-us, accessed July 2, 2023
[37] https://www.ifrs.org/news-and-events/news/2023/05/consultation-to-enhance-the-international-applicability-of-the-sasb-standards-now-open/, accessed July 9, 2023.



These ESG issues are all from a value-based investing perspective. [38] Evidence of this is the fact that every single one of them is discussed in the sections on "Business" and "Risk Factors" in the company's 2022 10-K.[39] This is a financial filing with the SEC where companies are required to disclose information that is material for investors.

[38] https://www.forbes.com/sites/bobeccles/2023/02/28/a-tedious-and-boring-analysis-of-two-items-in-exxonmobils-2022-10-k/?sh=2fa3615329e4, accessed July 2, 2023.
[39] https://ir.exxonmobil.com/sec-filings, accessed July 2, 2023.

Climate Change

According to a Yale survey on climate change, 72% of Americans think climate change is happening and 57% think it is mostly caused by human activities.[40] Addressing the challenges of climate change is not a liberal political agenda; it is necessary for America's energy security and economic competitiveness. Exclusion or divestment from fossil fuel companies based on an ideological animosity towards them is an ineffective strategy and an example of values-based investing.[41] Rather, investors must engage with these companies as they transform their business models for the inevitable energy transition, such as what is being done by the investor group Climate Action 100+.[42] These engagements, consistent with value-based investing, are about ensuring that these companies are effectively managing their climate-related risks and opportunities so they can deliver value to their shareholders for many years to come.

Greg Goff, a former oil and gas CEO and named in 2018 by the Harvard Business Review as one of the top CEOs in the world[43] has stated that climate change "is the biggest challenge of my lifetime."[44] Elaborating on this he observed, "In addition to having a sense of urgency, it is important there is very well-developed framework to drive change as we decarbonize. I believe we need to strengthen our competitive position in the world. Because energy is critical to our economic well-being as a country, the framework needs to deploy capital effectively and efficiently; support innovation; develop policies that enhance our competitive position; and consider all the consequences of the changes that we pursue. I do not believe that we have the luxury of driving change without considering and managing the impacts of change."

American Petroleum Institute

Goff's view is shared by the American Petroleum Institute (API) which states that "API and its members commit to delivering solutions that reduce the risks of climate change while meeting society's growing energy needs. We support global action that drives greenhouse gas emissions reductions and economic development."[45] Its "Climate Policy Principles" include (1) facilitate meaningful GHG emissions reductions and conservation from all sectors of the economy, (2) balance economic, environmental and energy security needs, (3) support market-based policies to drive innovation, (4) maintain the competitive positioning of U.S. businesses in global markets, and (5) continue to advance understanding of global climate change in order to calibrate and adapt future policies.

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[40] https://climatecommunication.yale.edu/visualizations-data/ycom-us/, accessed July 2, 2023.
[41] 'Does ESG Negative Screening Work? By Robert G. Eccles, Shivaram Rajgopal, and Jing Xie, SSRN, April 30, 2022, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4150524, accessed July 2, 2023.
[42] https://www.climateaction100.org/, accessed July 2, 2023.
[43] https://hbr.org/2018/11/the-best-performing-ceos-in-the-world-2018, accessed July 2, 2023.
[44] https://www.forbes.com/sites/bobeccles/2022/12/15/a-conversation-with-greg-goff-about-the-energy-transition-and-esg/?sh=5f554a0e5ba4, accessed July 2, 2023.
[45] https://www.api.org/oil-and-natural-gas/environment/climate-change, accessed July 2, 2023.

Conservative Climate Caucus

There is ample evidence to support the fact that dealing with climate change is an American issue, not a liberal political agenda. It is simply that the two parties have different views on how best to address the problem, with liberals more in favor of government policies and conservatives more in favor of market solutions, though each group largely sees the need for both.

Consider the 83-member "Conservative Climate Caucus" started and Chaired by Congressman John Curtis (R-UT) with Congresswoman Mariannette Meeker-Weeks (R-IA) as Vice Chair.[46] The caucus expresses six beliefs, the first one being "The climate is changing, and decades of a global industrial era that has brought prosperity to the world has also contributed to that change." It also notes that through private sector innovation America is the global leader in reducing emissions; climate change is a global issue and China is the biggest obstacle to solving it; Americans and the rest of the world want cheaper, reliable, and cleaner energy; with innovation, fossil fuels can and should be a major part of the global solution; and reducing emissions is the goal, not reducing energy choices.

Conservative NGOs

Three center-right nonprofits are working on policy solutions to the challenges posed by climate change. One is ClearPath, under the leadership of CEO Rich Powell.[47] Its "mission is to develop and advance policies that accelerate innovations to reduce and remove global energy emissions. To advance that mission, we develop cutting-edge policy solutions on clean energy and industrial innovation. An entrepreneurial, strategic nonprofit, ClearPath (501(c)(3)) collaborates with public and private sector stakeholders on innovations in nuclear energy, carbon capture, hydropower, natural gas, geothermal, energy storage, and heavy industry to enable private-sector deployment of critical technologies."

Climate change is a major focus of The R Street Institute. Their Energy and Environment team, which includes Beth Garza, Devin Hartman, Josiah Neeley, and Phil Rossetti, "seeks a cleaner environment through a combination of a thriving economy, well-founded science, and principles of market competition and limited government. Our experts have deep expertise in climate and environmental policy, as well as electricity policy."[48]

The Conservative Coalition for Climate Solutions (C3 Solutions), founded by Drew Bond and John Hart, notes that "The climate change debate has been hijacked by political forces. It's difficult to decipher what's true in a polarized environment. Too often, we're driven into partisan camps by media bent on sensationalism. But we share more common ground than

[46] https://curtis.house.gov/conservative-climate-caucus/, accessed July 2, 2023.
[47] https://clearpath.org/about-us/, accessed July 2, 2023
[48] https://www.rstreet.org/home/our-issues/energy-and-environment/, accessed July 2, 2023.

most think." Their approach: "It's time to promote an intellectually honest and evidence-based discussion about climate change and examine the human and economic costs of policy proposals."[49]

A Conservative Investor

John D. Skjervem is the Chief Investment Officer for the Utah Retirement Systems with assets of around $45 billion and is a vociferous critic of ESG.[50] He has observed that "Now completely politicized, ESG is a waste of time" and is actually impeding a successful response to the climate emergency challenge. Skjervem views divestment from fossil fuel companies as ineffective, with investor engagement with these companies being the better course of action (such as the Engine No. 1 campaign on ExxonMobil), thinks Scope 3 reporting will be a legal and bureaucratic morass which will impede emissions reduction, plans to hold fossil fuel assets for decades, and sees natural gas as playing a critical role in replacing coal. He has made multiple investments in renewables, as well as a few "moon-shot" energy technologies, such as fusion, noting that "From a place of humility, not ideology, we are deliberately allocating across a mosaic of energy investments because we don't know exactly how the transition will evolve and play out."

Skjervem is also a member of the Investment Advisory Group for the Alaska Permanent Fund Corporation. On September 22, 2022, he gave a presentation to them entitled ""Thoughts on Climate Change, Divestment, Energy Transition & Related Challenges."[51] His conclusion[52]:

- Climate change is happening now and faster and is potentially even more severe than already anticipated;
- The energy transition will require a reliable supply of hydrocarbons, hybrid solutions, and some moonshots;
- Divestment doesn't work since it pushes ownership into less responsible hands, is not a solution but rather part of the problem, and is a tax on the poor; and
- Major challenges include "NIMBYism," the energy transition will likely be inflationary, and China and India both present major obstacles.

Company Examples

Every single one of the companies in DRLL's top 10 holdings sees climate change as both a threat and opportunity to the world and their company. All of them report on Scope 1 and 2 emissions and have targets for reducing them.[53] Every single one of the top 10 companies in the

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[49] https://www.c3solutions.org/the-issues/, accessed July 2, 2023.
[50] "Utah Retirement Systems: Why ESG is a waste of time" by Sarah Rundell, *top1000funds*, January 26, 2023, https://www.top1000funds.com/2023/01/utah-retirement-systems-why-esg-is-a-waste-of-time/, accessed July 3, 2023.
[51] https://apfc.org/bot-video-archive/. Go to go to September 22, 2022) and his presentation starts at 1:48:10, accessed July 3, 2023.
[52] Ibid. P. 50 of presentation.
[53] Op. Cit. Valero Energy has been replaced by Phillips 66, but this is true for them as well.

MAGA ETF also discusses climate change and has plans for reducing their emissions, with some of them having specific targets to be achieved.

In analyzing the company's March 3, 2022 "Investor Day" virtual webcast, I have written favorably about how ExxonMobil is positioning itself for the energy transition, though I also stated it needs to be moving more quickly.[54] A May 25, 2022, press release states, "ExxonMobil said today it plans to grow shareholder value by delivering solutions that help meet the global need for energy and for lower greenhouse gas emissions to address climate change."[55] The Investor Day shows a company enjoying strong financial performance, upbeat about its future, and committed to evolving its business model to contribute to and benefit from the energy transition. The same is true for its May 31, 2023, Annual Shareholder Meeting.[56] And at an April 4, 2023 "Low Carbon Solutions" webinar the company said its renewables business could generate hundreds of billions of dollars in revenues and outperform its traditional oil & gas business as soon as a decade from now.[57] To me this is a clear signal that ExxonMobil is accelerating the pace of its business model transformation.

I have also written favorably about NextEra Energy Resources.[58] At the time Fisch and I wrote, NextEra was one of the top 10 holdings in the MAGA ETF. At the same time, in bright, bold letters on the home page of its website, the company states that "SHIFTING TO CLEAN ENERGY ISN'T AN OPTION. IT'S THE SOLUTION. More affordable. More reliable. More sustainable. The future of energy is here."[59] The company is the world's largest producer of wind and solar energy. It proclaims that "Our Real Zero Blueprint is the most ambitious target set by any U.S. utility or power generator." Backing up this claim is $50-55 billion in planned investments in American infrastructure through 2022, creating thousands of high paying American jobs. NextEra was recognized by *Fortune* as one of the top 20 companies in the world for innovation. It has also published an excellent "2022 Environmental, Social, and Governance Report."[60]

A final example is Verisk Analytics, a current top 10 holding in the MAGA ETF. "Verisk provides expert data-driven analytic insights that help business, people, and societies become stronger, more resilient, and sustainable."[61] In its "Statement on Climate Change" the company states "At Verisk, we have contributed to the large body of scientific evidence that clearly demonstrates the changes occurring in the Earth's climate system and the attendant risks to people, property,

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54 https://www.forbes.com/sites/bobeccles/2022/08/10/looking-at-climate-change-through-the-eyes-of-exxonmobil/?sh=472bc25624ad, accessed July 3, 2023.
55 https://corporate.exxonmobil.com/news/news-releases/2022/0525_exxonmobil-to-grow-shareholder-value-by-meeting-need-for-energy, accessed July 3, 2023.
56 https://investor.exxonmobil.com/news-events/annual-shareholder-meeting, accessed July 3, 2023.
57 https://investor.exxonmobil.com/news-events/ir-calendar/detail/20230404-low-carbon-solutions
58 https://www.forbes.com/sites/bobeccles/2022/12/10/a-suggested-target-for-house-hearings-on-esg-nextera-energy/?sh=3eed3b6f20b5, accessed July 3, 2023.
59 https://www.nexteraenergyresources.com/, accessed July 3, 2023.
60 https://www.nexteraenergy.com/content/dam/nee/us/en/pdf/2022_NEE_ESG_Report_Final.pdf, accessed July 3, 2023.
61 https://www.verisk.com/, accessed July 3, 2023.

and financial assets."[62] On April 4, 2022 the company announced the formation of a "Climate Advisory Council." Its purpose is "To help organizations better understand the impacts of climate change and inform their resilience and sustainability efforts" including "strategic guidance and feedback on climate change solutions Verisk is developing, such as the climate conditioning of the company's extreme event models."[63] The company's 2022 "Corporate Social Responsibility Report" has separate sections titled Environmental, Social, and Governance.[64] It reports on Scope 1, 2, and 3 emissions, and is on target to reduce its Scope 1 and 2 emissions 21% by 2024, compared to a 2019 baseline, a target based on Science Based Targets guidance in line with the Paris Agreement.

SEC Authority

On March 21, 2022, the SEC issued a proposed rule entitled "The Enhancement and Standardization of Climate-Related Disclosures for Investors."[65] Alan L. Beller, Daryl Brewster, David A. Katz, Carmen X. W. Lu, Leo E. Strine, Jr., and I have submitted a 51-page comment letter regarding this rule.[66] We are supportive of the rule but have some suggestions about how we think it could be made better. Here are the key points in our letter:

I. The SEC's statutory authority to require climate disclosure important to investors Is well-established and should continue to be respected by the Judiciary;
II. Universal disclosure by all public companies of Scope 1 and 2 emissions is transformational and the proposal underestimates its benefits—especially if the Commission addresses outsourcing of core economic functions and requires apples-to-apples reporting on Scope 1 and 2;
III. The Proposal can better encourage useful innovation by not requiring (or by postponing) the disclosure of Scope 3 emissions, and by encouraging voluntary disclosure by way of a safe harbor for issuers that choose to make voluntary disclosure. The same is true of disclosure of other innovative techniques such as internal carbon pricing;
IV. Make narrative requirements, including those proposed in financial statement notes, sync better with emerging private sector and international reporting regimes, and with principles-based disclosure, such as that found in MD&A;
V. Focus required attestation of Scope 1 and 2 emissions on an even larger size of public companies in the first phase, and phase in attestation requirements as to

[62] https://www.verisk.com/siteassets/media/corporate-social-responsibility/downloads/verisk-climate-change-statement-2022.pdf, accessed July 3, 2023.
[63] https://www.verisk.com/newsroom/verisk-assembles-climate-advisory-council/, July 3, 2023.
[64] https://www.verisk.com/siteassets/media/corporate-social-responsibility/verisk-corporate-social-responsibility-report-2022.pdf, accessed July 3, 2023.
[65] https://www.sec.gov/rules/proposed/2022/33-11042.pdf, accessed July 3, 2023.
[66] "Comment Letter- SEC File No. S7-10-22- The Enhancement and Standardization of Climate-Related Disclosures for Investors" by Alan L. Beller, Daryl Brewster, Robert G. Eccles, David A. Katz, Carmen X. W. Lu, and Leo A. Strine, Jr., SSRN, June 30, 2022, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4139637, accessed July 3, 2023.

other specified companies when the market of providers is broader, practices are better established, and implementation costs will be lower; and

VI. Emphasize education and facilitation as first priorities, and limit enforcement to the government itself, not by private right of action.

The SEC's proposed climate disclosure rule has received strong investor support.[67] They clearly regard information about a company's carbon emissions and how they are managing the challenge of climate change to be a material issue. Unfortunately, this legitimate need by investors has been confounded with the broader issue of the right public policy response to this challenge. In a piece published in the *Harvard Law School Forum on Corporate Governance,* "Turning Down the Heat in the ESG Debate: Separating Material Risk Disclosures from Salient Political Issues," Crowley and I begin by saying, "With political battle lines drawn over environmental, social and governance (ESG) disclosures, it is fair to ask whether the sustainability movement is itself sustainable. As a registered Republican (Crowley) and a registered Democrat (Eccles), we do hope that it proves to be sustainable because we see this movement as fundamental to how the capital markets can support the well-being of all Americans. But the movement is currently facing grave political challenges. The underlying reason for this is the conflating of material risk disclosures wanted by investors and resisted by companies with related political issues. Being clear about the distinction between the two would be useful to both parties."[68]

We then review the history of SEC actions to improve disclosure of material risks known by them, but which are not being reported to investors, evidence on climate change, the role of ESG in the Biden administration from a policy perspective, and the challenges facing fiduciaries.

We conclude: "It is thus up to the SEC to determine what additional disclosures companies should provide to investors about material risks. The benefits to investors of these disclosures must be balanced against the costs to the companies for providing them. As the SEC considers the many comments it has received on its promised climate disclosure rule, it must maintain this focus. Policymakers with different views about whether and how to address climate change need to recognize that this legitimate political debate is a separate issue from the need for companies to disclose known, material risks to investors."

Conclusion

On June 23, 2023, the ESG Working Group of the House Financial Services Committee published "Preliminary Report on ESG Climate Related Financial Services Concerns."[69] The report

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[67] https://www.ceres.org/news-center/blog/analysis-shows-investors-strongly-support-secs-proposed-climate-disclosure-rule#:~:text=Investors%20have%20spoken%E2%80%94they%20are,information%2C%20whether%20physical%20or%20transitional., accessed July 3, 2023.

[68] https://corpgov.law.harvard.edu/2022/09/01/turning-down-the-heat-on-the-esg-debate-separating-material-risk-disclosures-from-salient-political-issues/, accessed July 3, 2023.

[69] https://financialservices.house.gov/UploadedFiles/HFSC_ESG_Working_Group_Memo_FINAL.pdf, accessed July 3, 2023.

addresses eight priorities including proxy advice, proxy voting, ESG rating agencies, Federal regulation of the financial system, and European reporting regulations that will be imposed on U.S. companies doing business there.

Protecting investors requires that all of these topics be seen through the lens of value-based, not values-based, investing. This, in turn, requires that companies disclose on the material ESG issues that matter to value creation and are based on a set of standards. These standards must be based on balancing the costs to companies with the benefits to investors. Information is central to all three parts of the SEC's mission and this information includes material ESG factors.