Myth vs. Reality: ESG's Impact on Kentucky

Advocates commonly describe ESG as criteria for making strategic investment decisions to aid environmental or social causes one cares about. In reality, ESG policies risk failing Americans on a multitude of fronts.

State Pension Fiduciary Duty model legislation would protect Kentucky's investments and economic interests from the threat of the ESG movement by:

- **Clarifying the fiduciary duty** of those managing Kentucky's pension funds is to consider only financial factors, and that commitments to promote ESG goals are evidence of a motive to promote non-financial purposes.
- **Benefiting Kentucky retirees** by shifting assets to asset managers focused on financial purposes.
- Ensuring Kentucky's **shares are voted according to Bluegrass state values** by requiring that the shares of Kentucky's pension investments be voted only in the financial interest of the plan participants.

Opponents are spreading misinformation about the impact that this legislation could have on Kentucky. Here are the facts:

Myth 1: This legislation forces banks to violate federal rules.

Reality: The fiduciary duty model does not apply to banks. It applies to asset management firms. While some banks are large enough to have asset management arms, those are only a small number of the very largest banks.

Additionally, The Employment Retirement Income Security Act (ERISA) does not apply to state pensions, so there is no legal conflict. Even the Biden Administration's proposed rules *permit* the use of ESG, but do not require it: "Risk and return factors may include the economic effects of climate change and other environmental, social, or governance factors on the particular investment or investment course of action." A prohibition on the use of ESG in such cases will force asset managers to tailor products specifically for state pensions.

Myth 2: Isn't this just trying to solve a problem that doesn't exist for Kentucky?

Reality: There is plenty of evidence of how the broader ESG movement threatens Kentucky's economic interests. Kentucky is right to push back against those threats. ESG policies hurt Kentucky in two ways.

First, when Kentucky's asset managers follow ESG policies in investment decisions instead of fiduciary responsibilities, Kentuckyians are the ones who lose. For example, Blackrock declared that it would divest from coal in mid-2020 for ESG reasons.[1] Since July, 2020 the price of coal has increased from under $50/ton to close to $400/ton, an almost 800% return.[2] Anyone divesting from coal or coal-related assets for ESG reasons would miss a historic buying opportunity.

Second, using asset managers that engage and vote shares based on ESG can reduce the value of pension fund assets over the long-term. For example, Blackrock has voted against directors for failing to set emissions reduction targets or for increasing exposure to fossil fuel assets such as coal.[3] In 2020, Blackrock voted against the directors of a utility for increasing its exposure to coal related assets, even though such exposure would no doubt have been financially beneficial.[4] Such actions prevent companies from making money during periods when being anti-ESG is profitable. Over time, this will reduce the value of pension fund assets.

Myth 3: This type of legislation picks winners and losers among industries.

Reality: The model details what are examples of evidence of violating a fiduciary purpose. It does not provide a list of protected industries. The bill details how a "fiduciary may be reasonably determined to have taken an action or considered a factor with a purpose to further social, political, or ideological interests." It does not require that those actions listed as evidence be considered exclusively. This is similar to many other statutes that establish a standard and then provide examples. Because the law can't know what is going on in someone's mind, purpose is usually determined by referencing writings or other evidence of purpose.

The model lists categories of evidence that can be considered types of Fiduciary Commitment. These include written documents that could indicate state of mind, such advertising, statements, explanations, and membership in organizations. Notably, these pieces of evidence are limited to the fiduciary's commitments as a fiduciary. Commitments regarding the fiduciary's own internal operations are not relevant. The simple way to comply with the model would be to not make commitments as a fiduciary to anything other than maximizing returns for clients.

[1] https://www.blackrock.com/corporate/investor-relations/2020-blackrock-client-letter
[2] https://tradingeconomics.com/commodity/coal
[3] https://www.blackrock.com/corporate/literature/publication/our-commitment-to-sustainability-full-report.pdf
[4] Ibid.

Legislators are right to be clear in the law so there is no question on what defines violating a fiduciary responsibility.

Myth 4: ESG legislation distorts the free market.

Reality: The market for asset management is being distorted by state actors who use finance as a form of regulation. Pension funds like New York have committed to reach net zero across all of their assets.[5] This means that they expect asset managers to not only reach net zero for assets managed by blue states, but across all of the assets they manage. New York City Comptroller Brad Lander made this clear in his letter to Blackrock.[6]

This means that large asset managers and their Leftist-state clients are working hand-in-hand to reshape public companies. Multiple Left-wing state governments have joined Climate Action 100+ along with large asset managers to pressure companies to reach net zero. Those state treasurers or pension funds include California, New York, New Jersey, Illinois, Chicago, San Francisco, Seattle, and Oregon.

Climate Action 100+ reported how the coordinated efforts of asset managers and Left-wing state clients resulted in new board members at ExxonMobil.

> *ExxonMobil shareholders elected three new board members to the company's board. This was backed publicly by three of the largest pension funds in the U.S. and Climate Action 100+ signatories – CalPERS, CalSTRS, and the New York State Common Retirement Fund. This followed extensive engagement coordinated by Climate Action 100+.*[7]

By doing nothing, financially-focused states like Kentucky perpetuate a distorted market where activist Left-wing states pressure asset managers and companies to meet the Left's environmental goals. Rather than doing nothing, Kentucky should establish clear principles for their investments. That is what this legislation would do.

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[5] https://comptroller.nyc.gov/wp-content/uploads/2022/09/Letter-to-BlackRock-CEO-Larry-Fink.pdf
[6] Ibid.
[7] https://www.climateaction100.org/wp-content/uploads/2022/03/Climate-Action-100-2021-Progress-Update-Final.pdf