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## Texas' ESG Attack Sweeps Up Some Funds That Aren't Really ESG.

**Almost 40% of the funds targeted by state comptroller have investments in fossil-fuel stocks.**

A Texas statute targeting perpetrators of "ESG" includes a significant number of investment funds that don't have a genuine environmental, social or governance focus.

Of the 348 funds singled out by Texas Comptroller Glenn Hegar, 14% don't qualify as ESG, according to an estimate by Morningstar Inc. What's more, almost 40% invest in the oil and gas industry they're accused of boycotting, data compiled by Bloomberg show.

It's the latest counter-intuitive moment in an unlikely battle that has thrust a once obscure financial acronym into the center of American politics. Ironically, many of the firms and funds targeted by the GOP for sidelining oil and gas have been criticized by climate activists for their continued support of the fossil-fuel industry.

"The fact that many funds on the banned fund list hold companies involved in the oil and gas industry raises questions about the research done by the Texas comptroller on these investments," said Hortense Bioy, global director of sustainability research at Morningstar. "Clearly, these funds aren't boycotting energy companies."

The state's position hasn't changed since the decision was announced last month, said Chris Bryan, director of communications for the Texas comptroller. The test isn't that the funds are ESG focused, the test is on whether the funds boycott energy companies based on state statute, which is broader than just having oil and gas investments, he said.

"If new information is provided to us about the funds, we will actively consider whether to update the list and we will do this on a regular basis," Bryan said.

Hegar denounced Wall Street and "environmental crusaders" in August for creating a "false narrative" that the economy "can completely transition away from fossil fuels, when, in fact, they will be part of our everyday life into the foreseeable future." Aside from 348 investment funds, the state targeted 10 asset managers and banks, including BlackRock Inc. and Credit Suisse Group AG. Texas Attorney General Ken Paxton also has joined a multistate investigation, questioning Morningstar's use of "ESG factors."

BlackRock, which has since been slammed by Democratic states for appearing to backtrack on its pledge to cut $CO_2$ emissions, said GOP attacks ignore the fact that it holds more than $100 billion in Texas energy companies. It would therefore be "inaccurate" to accuse it of boycotting fossil fuels, Dalia Blass, BlackRock's head of external affairs, said on Sept. 7.

Applying an ESG investment approach generally entails screening for environmental, social and governance opportunities and risks. Some fund managers apply exclusion policies, while others adopt so-called engagement strategies, whereby they continue to hold sectors such as oil and gas with a view to helping the companies adapt to a low-carbon world. ESG often faces criticism from activists for being too focused on financial performance.

The fund managers boycotted by Texas have failed “to provide assurance that they are taking sufficient steps to address the climate crisis,” said Pete Uhlenbruch, director of financial sector standards at sustainability nonprofit ShareAction.

Funds targeted by Hegar include BlackRock’s iShares ESG Aware MSCI USA ETF (ticker ESGU), which holds shares of Exxon Mobil Corp., Chevron Corp., ConocoPhillips and Halliburton Co.; CREF Social Choice Account, which has stakes in Kinder Morgan Inc., Schlumberger NV and Southwestern Energy Co.; and Vanguard ESG US Stock ETF (ESGV), which has investments in companies including Murphy USA Inc.

Vanguard Group’s “only objective is to maximize investment returns for our clients and help them achieve their financial goals,” said spokesperson Emily Ferrell.

Over the past decade, Morningstar estimates US investors exposed to ESG strategies saw investment returns that were consistently between one and seven percentage points higher than those of conventional funds.

Others note that fund managers have increasingly limited investment options because more and more companies incorporate ESG considerations into their business models.

“So many companies are now setting science-based emission reduction targets and embracing bold climate action that large investors would struggle to build any kind of profitable portfolio that excludes such businesses,” said Maria Mendiluce, chief executive of the We Mean Business Coalition.

That said, Republican Party concerns that the oil and gas industry isn’t getting enough money from big finance appear overdone. Banks have loaned $302 billion to fossil-fuel companies this year, compared with $268 billion in the same period of 2021 and $256 billion in 2020, according to Bloomberg data.

At the same time, there are signs that ties are continuing between the financial firms vilified by the GOP, and the states publicly attacking them.

Five firms targeted in a pair of anti-ESG statutes passed by Texas a year ago led to the initial departure of Goldman Sachs Group Inc., JPMorgan Chase & Co., Fidelity Capital Markets, Bank of America Corp. and Citigroup Inc. Their absence caused borrowing costs for Texas municipalities to rise by as much as $530 million, one study shows.

Since then, a number of those same banks appear to be back in. JPMorgan, for example, wasn’t included in an updated version of Texas’ list, and now intends to begin bidding on public contracts again.

Meanwhile, regulators policing the finance industry are taking steps to set up guardrails around what asset managers can call an ESG investment. In May, the US Securities and Exchange Commission proposed tougher disclosure requirements, while asset managers targeting EU clients face a January deadline to provide investors with more information.

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