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"Where Woke Goes to Die"? - New Florida Restrictions on ESG to Create Challenges and Additional Requirements for Asset Managers and Other Financial Institutions - Ropes & Gray

After many months of publicly teasing further anti-ESG action, Florida is poised to become the latest state to enact legislation limiting the consideration of ESG factors in the investment decisions of state retirement systems. House Bill 3, "An Act Relating to Government and Corporate Activism", ("HB 3") passed in the Florida State Senate on April 19. The legislation, which is expected to be signed by Governor Ron DeSantis in the coming days, formalizes and expands the directive he announced last August for the State Board of Administration to invest funds of the Florida Retirement System Defined Benefit Plan (and to exercise shareholder proxy voting rights) solely based on pecuniary factors, without sacrificing investment returns to promote non-pecuniary factors such as ESG goals. HB 3 will extend this policy to cover all funds invested by state and local governments, including, general revenue, trusts dedicated to specific purposes, money held by retirement plans, and surplus funds. These restrictions will apply to all contracts executed, amended or renewed beginning July 1. The legislation also will put in place new requirements and restrictions applicable to state and municipal bond issuances, government contracting and banks and other financial institutions. In this Alert, we discuss HB 3 in more detail, with a focus on asset managers.

HB 3 is one of the strictest and most restrictive anti-ESG laws adopted to date, imposing significant new compliance obligations that are distinct from those required by ERISA and other state laws. Given Florida's status as a frequent investor in funds, this development is likely to have an impact on many managers across a wide range of strategies. While HB 3 reflects an amalgam of policies and restrictions that have gained traction in other states—for example, Kentucky, Idaho, Montana, and Utah among other states have passed legislation that mandate a focus on pecuniary or financial factors for investing public assets—the Florida legislation includes some novel provisions that will require asset managers' special attention.

- **Investment Decisions Made on Behalf of Florida's Funds Must Be Based on Pecuniary Factors** – HB 3 requires that the Florida Chief Financial Officer, or any party authorized to invest public funds on his or her behalf, make investment decisions based solely on the basis of pecuniary factors. A pecuniary factor is defined as one that 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 and that does not include the consideration of social, political, or ideological interests. Further, the "weight given to any pecuniary factor must appropriately reflect a prudent assessment of its impact on risk or returns." This is very similar to the approach that the Trump administration took in its ESG rule pursuant to ERISA, which was adopted in 2020 (See our prior Alert) but has since been rescinded. Similar to that rule, HB 3 can be expected to sharply limit the ability of fiduciaries of Florida's public retirement plans (which includes any managers investing assets on behalf of the state plans) to consider ESG factors as part of their investment decisions.
- **ESG Bond Prohibition** – The bill prohibits both the state Division of Bond Finance and specified

public bond issuers from (1) issuing an ESG bond, (2) paying for the services of another to verify or certify a public bond as an ESG bond, or (3) contracting with rating agencies that use ESG scores in a manner that directly impacts the issuer's bond ratings.

The term "ESG Bonds" refers to (1) any bonds that have been designated or labeled as bonds that will be used to finance a project with an ESG purpose, including, but not limited to, green bonds, Certified Climate Bonds, GreenStar designated bonds, and other environmental bonds marketed as promoting a generalized or global environmental objective; (2) social bonds marketed as promoting a social objective; and (3) sustainability bonds and sustainable development goal bonds marketed as promoting both environmental and social objectives. The term includes those bonds self-designated by the issuer as ESG-labeled bonds and those designated as ESG-labeled bonds by a third-party verifier.

This bill may make it harder and more costly to underwrite Florida bonds.

- **Selection of Government Contractors** – For government contracting, the bill prohibits all units of state and local government from: (1) considering social, political, or ideological beliefs when evaluating prospective vendors; or (2) giving any preference to a vendor based on social, political, or ideological beliefs.
- **Use of Social Credit Scores as an "Unsafe and Unsound Business Practice"** – Other financial institutions such as banks, trust companies, credit unions, consumer finance lenders, and money services businesses may be subject to administrative sanctions if they engage in an "unsafe and unsound business practice" by canceling or denying services or otherwise discriminating against a service provider on the basis of that provider's political or religious beliefs or affiliations, social credit rating or score, or any other factor that is not a quantitative, impartial, risk-based standard. For instance, refusal to do business with a service provider because of its involvement in the firearms or fossil fuel industries may constitute a violation of this requirement.
- **"Stickering" Requirement for Investment Managers** – The bill requires investment managers that invest public funds on behalf of a Florida state or local government entity to comply with a stickering requirement to include a disclaimer in any external written communication with a company in which the investment manager has invested public funds if (1) that written communication discusses social, political, or ideological interests, (2) subordinates the interests of the company's shareholders to the interests of another entity, or (3) advocates for an entity other than the company's shareholders. The required disclaimer must state the following: "The views and opinions expressed in this communication are those of the sender and do not necessarily reflect the views and opinions of the people of the state of Florida." Managers may be required to sticker a wide range of communications. The Florida governmental entity has the unilateral right to terminate any contract with an investment manager that is executed, amended or renewed on or after July 1 if the required disclaimer is not included.
- **Annual Compliance Certification for Investment Managers** – Additionally, investment managers are required to annually certify that they are complying with the fiduciary standards set forth in Florida's investment policy (i.e., investment decisions are made based solely on pecuniary factors and do not subordinate the interests of the participants and beneficiaries of the funds to other objectives, including sacrificing investment return or undertaking additional investment risk to promote any nonpecuniary factor). Managers will be subject to sanction if they fail to timely file the required certification or submit a certification that is materially false. The Florida Attorney General may bring a civil or administrative action against such persons and recover attorney's fees and costs when such an enforcement action is successful.

Further Information on State ESG Regulation

Be sure to check out our award-winning interactive website, Navigating State Regulation of ESG

Investments, that tracks the latest ESG-related legislation, executive actions and initiatives, and coalition activities, as well as changes to state retirement plan investment policies across the United States. In addition, the website offers a variety of podcasts and memos to provide users with easy access to our team's key insights in understanding this dynamic area.

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