Bond Case Briefs

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Wall Street Thrived, Small Towns Lost as Anti-ESG Campaign Raged in 2023.

In 2023, a fervent anti-environmental, social and governance campaign swept state legislatures but failed to curtail the movement's main foe: Wall Street and its multitrillion-dollar asset management firms.

At the same time, the new state policies seeking to eliminate ESG considerations from public investments had some real-life consequences for cities and towns caught by the new mandates.

In Texas, the municipal bond market is in turmoil after the state's attorney general, Ken Paxton, issued an advisory in October to state and local government agencies asking them to be on the lookout for bond underwriters that may "boycott energy companies, discriminate against firearm entities or associations, or boycott Israel." Paxton's letter included a list of 22 companies he accused of violating Texas laws passed in 2021 to protect such interests.

Within days, the city of Del Rio on the Mexican border dropped RBC Capital Partners, its lead underwriter for a $12.5 million municipal bond deal, and replaced it with BOK Financial Corp., an Oklahoma-based firm that had escaped Paxton's scalpel. Paxton's public finance division had told the city of 34,000 it might not be able to close on schedule with RBC, prompting a last-minute scramble.

"It was very much a timing issue for the city," said Jay Juarez, Del Rio's bond counsel.

Around the same time, a Houston-area school district dropped Wells Fargo & Co. from a $310 million bond after Paxton indicated the company's practices were being reviewed. A Wells Fargo spokesperson declined to comment.

Neither RBC Capital nor Wells Fargo is on the Texas Comptroller's Office's most recent list of financial services companies, updated in December 2023, that boycott energy firms.

Similar situations have played out in other states.

Uproar in Oklahoma

In the spring of 2023, the city of Stillwater, Okla., an hour north of Oklahoma City, had lined up a low-interest $13.5 million loan from Bank of America Corp. to install energy-efficient lighting and replace two aging heating and cooling units in municipal buildings. The saved energy costs from the improvements would pay off the loan over 15 years, according to the city's deal with the bank.

That plan was halted when Oklahoma Treasurer Todd Russ in May published an initial list of 13 financial institutions, including Bank of America, barred from doing business in the state. Russ had determined that the companies violated the state's 2022 Energy Discrimination Elimination Act by boycotting energy companies.

Russ revised the list in August, naming six companies, including Bank of America.

“I appreciate that this is a fossil fuel state and the intention behind it, but the law passed here had not been vetted very well,” Stillwater Mayor Will Joyce said in an interview. “I even had some folks at the legislature tell me they never intended for the bill to have an impact on local municipalities.”

Like the Texas law, Oklahoma’s measure was among 36 bills lawmakers in 18 states passed over the last two years to blacklist banks and asset management firms that consider ESG risks and opportunities in investment decisions, data from the law firm Ropes & Gray shows.

An early 2023 analysis by Econsult Solutions Inc. estimated that six states including Oklahoma could see up to $708 million in higher borrowing costs by barring some banks from underwriting municipal bonds. Undeterred, ESG critics are pushing forward.

Republicans in Congress and GOP-controlled state legislatures say large money managers wield too much influence over pensions, bonds and other public investments, accusing them of playing politics with money they do not own. As the 2023 state legislative sessions wound down in early summer, about half of the anti-ESG bills introduced had not passed. But more than 40 will be automatically reintroduced in 2024, and new bills are expected.

‘A fiduciary responsibility’

By October, Oklahoma lawmakers were discussing how to amend their energy discrimination law to better protect cities like Stillwater. The state’s second-largest public pension system had also resisted the restrictions in the law. The Oklahoma Public Employees Retirement System voted 9-1 in August to retain BlackRock Inc. and State Street Corp. as investment advisers even though those banks were on the treasurer’s blacklist.

“We were talking about a potential $10 million hit to our pensioners,” Oklahoma Insurance Commissioner Glen Mulready, a member of the pension system’s board and former Republican state lawmaker, said in an interview. “If we thought that we could have abided by the law without hurting the pension fund we would have done that in a heartbeat. But we have a fiduciary responsibility.”

The disagreement between the treasurer and the pension system has yet to be resolved, Mulready said.

Adding to the ESG drama in Oklahoma, a retiree and former president of the Oklahoma Public Employees Association in November filed a lawsuit against the state and its treasurer, calling the state’s anti-ESG legislation “government overreach” and a violation of free speech. The lawsuit was backed by three groups representing public state employees.

Business as usual for Wall Street

Meanwhile, banks on state non grata lists — including BlackRock, JPMorgan Chase & Co., State Street and Vanguard Group Inc. — continued to do business in states such as Florida, Texas and West Virginia that had been especially vocal ESG critics.

Now navigating a patchwork of different state policies as well as different regulations overseas, US financial firms have to be more strategic in how they tailor their communications while also avoiding potential legal pitfalls, said Josh Lichtenstein, a partner with Ropes & Gray. That does not mean they have changed their investment strategies, he said.

BlackRock’s high-profile CEO, Larry Fink, a frequent Republican target over his company’s investment policies, made headlines in June when he said BlackRock was abandoning the term ESG. The company would instead choose more specific words like decarbonization or corporate governance, which Fink summed up as "conscientious capitalism."

"That's the progressive left's ammo: Once we figure out what their acronyms really mean they're going to change it," said Derek Kreifels, CEO of the State Financial Officers Foundation, speaking to a London journalist in November about his group's support for state anti-ESG efforts.

In October, BlackRock launched a new "climate-transition oriented" private debt fund to meet the growing needs of institutional investors who set low-carbon and climate transition goals for their portfolios. A survey of 200 large investors in 15 countries the asset manager conducted a few months earlier found that 98% of investors fall into that category, the company said.

For other players, it is business as usual. JPMorgan Chase, deemed by shareholder activist group As You Sow and others to be the world's largest fossil fuel investor, published an ESG report as recently as May 2023. It also has detailed on its website how the investor plans to channel $2.5 trillion this decade for sustainable development.

Both asset management firms remain members of the Net Zero Asset Managers initiative, an alliance vilified by ESG critics. Its signatories commit to work with clients to decarbonize their portfolios by 2050 in alignment with the Paris Agreement on climate change.

New realities for community banker, small-town mayor

Even in Florida, which in May enacted what is arguably the nation's strictest anti-ESG law, Climate First Bank continues to attract new customers "who wish to bank with the world's first [Federal Deposit Insurance Corp.]-insured bank found to combat the climate crisis." Ken LaRoe, the community bank's founder and CEO, said in an email.

But because of the new Florida law, known as H.B. 3, "we are required to bank any industry, including dirty energy, tobacco, the for-profit prison industry and others," LaRoe wrote. Such companies had previously been on the bank's exclusionary list, which the law revoked.

An analysis by the law firm Akin Gump says the Florida law limits investment decisions for state pension assets to "pecuniary factors," and prohibits consideration of "any social, political or ideological interests." Local governments are prohibited from considering ESG principles in investment decisions and in awarding contracts.

By contrast, Oklahoma's law has some wiggle room, enough to offer a possible solution for Stillwater and its stalled capital improvement project.

Oklahoma Attorney General Gentner Drummond had considered the city's calculations showing that going with a lender other than Bank of America would cost Stillwater $1.2 million in lost energy savings and shrink the city's project.

In a letter to the mayor, the attorney general wrote his "position" is that the loss qualified the city and Bank of America for an exception under the 2022 energy discrimination law.

"But that was not a binding legal opinion," Joyce said. "What is the city's liability if someone else in a few years tries to enforce the law? We had no certainty."

So Stillwater decided to look within for funding for its energy efficiency upgrades. Rather than taking 12 months, the project will now take several years and there is no guarantee the funding will remain, Joyce said. "Overall," he said, "we're in a worse situation."

S&P Global Capital

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