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Florida Enacts Anti-ESG Legislation – House Bill 3 Explained

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On May 2, 2023, Gov. Ron DeSantis (R-FL) signed into law House Bill 3 (HB3), legislation that, among other things, blocks the consideration of environmental, social and governance (ESG) factors in state and local investment decisions and procurement processes. As we have written about previously (e.g., here), the politicization of ESG is creating significant complexities for companies that do business in multiple jurisdictions, some of which require or permit the consideration of ESG factors, and others that have adopted anti-ESG legislation similar to HB3. That said, HB3, which is scheduled to take effect on July 1, 2023, is considered among the farthest reaching anti-ESG legislative enactments to date. The following alert describes HB3's requirements.

At a high-level, HB3 requires that investment decisions (and proxy voting decisions) for state pension assets be made taking into account only "pecuniary factors." For purposes of the legislation, "pecuniary factors" are defined as factors that are "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." Importantly, the term prohibits "the consideration of…any social, political or ideological interests" when state and local officials make investment and other covered decisions. Notably, in addition to applying to investment decisions relative to state pension assets, among other things, HB3 also places limits on investment decisions for local governments; prohibits the issuance of ESG bonds in Florida; and imposes limits on state procurement processes. More specifically:

- Managers of Florida's state pension assets can only take into account pecuniary factors when evaluating investment opportunities and cannot consider any non-pecuniary factors (i.e., ESG principles) when making these investment decisions. Similarly, the Florida Chief Financial Officer, which is an elected position, may only consider pecuniary factors when making investment decisions. Furthermore, the law requires certain investment managers and advisers to provide an annual written certification stating that investment decisions are based solely on pecuniary factors. Failure to timely file the certification may lead to termination of certain contracts between the investing entity and the investment manager/adviser. A materially false certification is deemed a willful refusal to comply with the investment manager's or adviser's fiduciary standard. In each case, failure to comply with this certification requirement may give rise to civil or administrative action by the Florida Attorney General.
- Relatedly, when determining how to exercise shareholder rights (e.g., proxy voting decisions), public fund managers may only consider pecuniary factors in making such determinations; non-pecuniary factors may not be considered.
  - The statute also imposes annual reporting requirements on such managers relative to shareholder voting decisions, providing assurances with respect to discharging duties consistent with HB3's requirements and governance policies.
- Under HB3, local governments are prohibited from considering any ESG principles when making any investment decisions. All such decisions must be made solely on the basis of pecuniary factors.

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- With respect to procurement processes, state and local officials may no longer consider ESG factors when awarding government contracts and HB3 expressly prohibits favoring any vendors on the basis of such factors.
- HB3 redefines the term "qualified public depository" (i.e., institutions that can accept and hold Floridian deposit funds) to include only those institutions that invest deposited funds solely on the basis of pecuniary factors. Relatedly, under HB3, these institutions cannot deny services on the basis of failing to satisfy certain ESG-related goals (e.g., net-zero emissions targets or diversity, equity and inclusion (DEI)-related goals in the boardroom).
- HB3 makes it an "unsafe and unsound practice" for financial institutions to "deny or cancel its services to a person, or to otherwise discriminate against a person when making available such services or in the terms or conditions of such services" on the basis of a person's political opinions, speech or affiliations; religious beliefs or affiliations; any factor that is not "quantitative, impartial, and risk-based"; or the use of any "rating, scoring, analysis, tabulation, or action that considers a social credit score." Some reports have interpreted this new provision to mean that financial institutions cannot prohibit extensions of credit to certain industries (e.g., traditional energy companies and gun manufacturers).
- HB3 prohibits the issuance by the state or any municipality of ESG bonds (i.e., bonds that are issued with a particular ESG goal or ESG-related purpose). Relatedly, HB3 prohibits the state and local governments from entering into contracts with any rating agency that could issue an ESG-related rating that adversely affects the bond rating of a particular issuer.
- Pursuant to HB3, when governmental entities enter into contracts with private investment managers, such contracts must include a provision governing written communications between such investment managers and a company in which such investment manager invests public funds on behalf of the governmental entity. Specifically, to the extent such written communications discuss "social, political, or ideological interests"; subordinates the interests of the company's shareholders to the interests of another entity; or advocates for any party other than the company's shareholders, then such communication must include a conspicuous disclaimer reading "[T]he views and opinions expressed in this communication are those of the sender and do not reflect the views and opinions of the people of the State of Florida."

HB3 is part of a larger effort by some who question the efficacy of using ESG factors in making investment decisions, developing financial products and in relation to corporate strategic decision making. Indeed, in March, Gov. DeSantis and 17 other governors announced the formation of an "alliance" that aims to "protect individuals from the ESG movement," including prohibiting the consideration of ESG factors when state and local governments are making investment decisions. This alliance is consistent with other efforts to "blacklist" major asset managers that are known for taking ESG risk factors into consideration when making investment decisions. For instance, Oklahoma became the latest state to warn certain major financial institutions of potential divestiture based on their deemed boycotting of fossil fuels by including them on their initial list of "Restricted Financial Companies." Relatedly, you will recall that President Biden recently vetoed an effort by congressional Republicans to prevent pension fund managers from using ESG factors when making investment decisions. That legislation related to a final rule published by the U.S. Department of Labor (DOL) (which we wrote about **here**) that permits plan fiduciaries to consider ESG factors when evaluating investments. Meanwhile, according to a recent report from S&P Global Ratings, sustainable municipal bond issuances during the first quarter of 2023 grew by 13% year over year, to $8.96 billion.

HB3's requirements will undoubtedly raise complex questions in terms of whether certain investment processes and procedures are implicated by the legislation. Because the analysis of any particular scenario will vary based on relevant facts and circumstances, we encourage you to consult with counsel in relation to any questions you may have relative to complying with HB3.

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