BY SAM LOUIS TAYLOR

A Brewing Debate Over ESG

Public companies, including banks, are being pressured by activists and some investors to disclose more information about the real-world effects of their activities — an effort known as the Environmental, Social, and Governance (ESG) movement. While the "E" (for environmental) often garners the most attention, ESG encompasses a broader range of issues and practices. As a result of this controversy, a debate is underway over ESG-related disclosure requirements.

This movement, which was first mentioned in a modern context in a 2004 United Nations report, is the newest iteration of a long line of efforts to push companies to promote goals that serve a broader audience of stakeholders than simply investors. The idea of socially focused business practices goes back to the anti-slavery investing practices of Quakers during the 1700s, the labor organizing and industrialist-led philanthropy movement starting in the 1800s, and the apartheid divestment campaigns of the 1970s and '80s. In the modern era, the ESG movement has been pushing businesses to identify, and often to mitigate, risks related to a broad range of topics, including climate change, biodiversity, supply chains and labor standards, community relationships, and executive pay.

Though support for ESG efforts does not easily break down along standard political lines, Democrats at the federal and state level are generally seen as supporting greater use of ESG metrics and reporting by businesses. This includes proposed requirements by the Securities and Exchange Commission (SEC) of disclosures related to a public company's effects on climate change, as well as efforts in Congress to require disclosure of the racial, gender, ethnic, and veteran composition of their boards and senior executives. Supporters of these efforts by the SEC argue that the additional transparency will make it easier for investors to hold companies accountable for their environmental promises, ensuring, for example, that corporate promises on combating climate change reflect genuine efforts and are not simply marketing ploys. Supporters of the board diversity proposal, such as Rep. Greg Meeks, D-N.Y., argue that it can be a tool to push the leadership of public companies to better reflect the demographics of the nation. At the end of the day, supporters argue, investors are driving the demand for greater disclosures of ESG information. In their view, if the market is driving this decision, then government should assist them in that effort or, at least, not stand in their way.

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The opposite side of this argument is perhaps best summed up by a famous 1970 essay from economist Milton Friedman, who argued that "there is one and only one social responsibility of business — to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud." Friedman argued that since corporate funds belong to shareholders, not executives, companies should invest their resources in creating profits and then return excess earnings to shareholders who can then use those earnings on any social or political cause as they see fit.

In the policy realm, some Republicans at the federal and state level see ESG requirements as a Trojan horse for pushing a specific political agenda. Many states, including Texas and West Virginia, have passed specific laws that ban their state agencies and pension funds from doing business with firms that "boycott" energy and fossil fuel companies, industries of importance to those two states. In Congress, Republicans, led by House Financial Services Chairman Patrick McHenry, R-N.C., have announced a broader review of ESG-related policies, including an effort to push the SEC to back away from its proposed disclosure rule related to climate change. There are proposals from other members that would prohibit banks from refusing to lend to certain industries, such as fossil fuel companies and firearm manufacturers, in the pursuit of environmental or social goals. On Jan. 14, 2021, during the closing days of the Trump administration, the Office of the Comptroller of the Currency issued a rule banning such policies on the part of certain financial institutions that it regulates; the agency put the rule on hold later that month.

While McHenry says he sees value in promoting responsible corporate governance, an issue that does have "a significant bearing on economic outcomes," he wants to make sure that corporations can "focus on their key knitting" and allow Congress to take the lead on tackling complex political problems.

"Governance does matter," McHenry stated at a December 2022 event hosted by CNBC, "but when we get into the question of environmental policy, it's necessary for Congress to tackle climate change." **EF**