MAY 2023

FISCAL NOTES

Fighting a Fossil Fuels Boycott

By Spencer Grubbs

The Texas Comptroller of Public Accounts has determined 11 financial companies, as of this writing, are boycotting the oil and gas industry pursuant to legislation commonly referred to as Senate Bill (SB) 13. Texas public investment entities subject to the bill must avoid contracting with, and divest from, these companies unless they can demonstrate this would conflict with their fiduciary duties.

Texas Comptroller Glenn Hegar explains that events including the war in Ukraine remind Texans they are best served when energy is the most affordable and reliable, and energy is made more affordable and reliable by a diverse portfolio of energy sources that includes dispatchable oil and gas. This energy diversification is important to Texas' economy.

"Texas has long been our country's energy leader," says Hegar. "Our state has always been the top oil and gas producer, and in recent years, it has become the leading renewable energy producer, too."

SB 13 stemmed from state officials' concern that prominent financial institutions and investment funds are moving to effectively ostracize Texas' oil and gas industry in favor of alternative energy — potentially putting the state's energy diversity at risk and ultimately doing more harm than good for the state's fiscal well-being and the best interests of Texans.

> **"Our state has always been the top oil and gas producer, and in recent years, it has become the leading renewable energy producer, too."**
>
> – Comptroller Glenn Hegar

A Message from the Comptroller

My office is keeping a close eye on recent trends in environmental, social and governance (ESG) investing and how they affect the Texas economy. The ESG concept has been around for a while — nearly 20 years, in fact — as one of many ways to give investors, including the folks who only dabble in the stock market, an additional framework for deciding where and how to invest. But we're concerned the ESG framework has become more of a marketing tool than a tool for making investment decisions. It is opaque, lacks transparency and has evolved into a campaign by financial institutions to stymie loans and capital needed by the oil and gas industry that helps support our state's economy.

The abbreviation ESG is thrown around a lot in financial circles, so we want to take the opportunity in this month's issue of *Fiscal Notes* to explain what it is and how it came to be. Put simply, ESG measures should be designed to give investors the option of gauging investment risks and growth opportunities based on companies' corporate policies, practices and impacts. However, there is no universally agreed-upon definition of what constitutes ESG, and performance measures often can be inconsistent at best. Many ESG-focused investment fund managers establish their own criteria to distance prospective investors from industries the managers deem socially and environmentally irresponsible or unsustainable.

Although rooted in a practice called socially responsible investing that gained traction back in the 1920s, ESG investing first made an appearance in a 2004 United Nations report endorsed by 20 global financial institutions, and it has grown in popularity. One study estimates that total ESG assets under management across the globe will increase from more than $18 trillion in 2021 to nearly $34 trillion in 2026 — almost doubling in five years. Another study, meanwhile, reports that assets under management are significantly lower than previously projected.

You also can read about my agency's work to implement legislation that addresses the boycotting of oil and gas companies by ESG-centric banks and investment firms. In the energy arena, the ESG movement has pushed for some businesses and investors to pick sides — between conventional energy sources like oil and natural gas and renewable energy sources like wind and solar. The law that went into effect in September 2021 seeks to level the playing field and, I hope, spark intellectually honest conversations about the importance of fossil fuels to our daily lives and the Texas economy.

As always, I hope you find this issue informative.

Glenn Hegar

Texas Comptroller of Public Accounts

TEXAS SUPPLY CHAIN

[CHEMICALS]

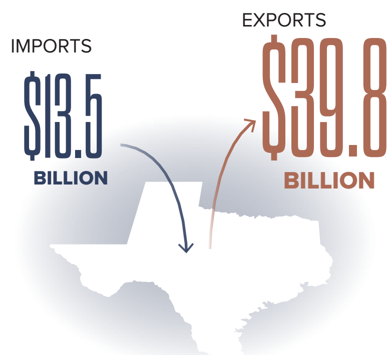
Texas is the nation's top chemical producer and exporter. The basic ingredients originate in oil and gas fields and travel an immense worldwide supply chain that eventually yields plastics, packaging, fertilizers, pesticides, synthetic fibers, cleaners, lubricants, paint and a seemingly endless list of other materials.

TEXAS' BASIC CHEMICAL MANUFACTURING INDUSTRY ACCOUNTS FOR ABOUT ONE-THIRD OF THE INDUSTRY'S U.S. EXPORTS AND GDP.

ONE IN A SERIES OF REPORTS THE COMPTROLLER HAS PREPARED ON TEXAS SUPPLY CHAINS

Texas Chemical Manufacturing Industry

ALL TEXAS CHEMICAL MANUFACTURING, IMPORTS AND EXPORTS, 2020



The top locations for Texas chemical manufacturing jobs are Harris County (29.7 percent) and Brazoria County (9.0 percent). In 2020, the share of industry jobs in Brazoria County was more than 10 times the national average.

AVERAGE ANNUAL WAGES	EMPLOYMENT	GROSS STATE PRODUCT
$113,372	83,534	$52.7 BILLION

Sources: JobsEQ and U.S. Census Bureau, USA Trade Online

TOP TEXAS COUNTIES BY CHEMICAL MANUFACTURING EMPLOYMENT, 2020

COUNTY	NUMBER OF EMPLOYEES, BASIC CHEMICAL MANUFACTURING	INDUSTRY CONCENTRATION, BASIC CHEMICAL MANUFACTURING	NUMBER OF EMPLOYEES, ALL CHEMICAL MANUFACTURING	INDUSTRY CONCENTRATION, ALL CHEMICAL MANUFACTURING
HARRIS	12,129	5.13	24,832	1.82
BRAZORIA	6,780	55.72	7,481	10.64
DALLAS	1,383	0.79	6,901	0.68
TARRANT	269	0.28	5,601	1.01
JEFFERSON	2,286	19.16	3,747	5.44

Source: JobsEQ. Data are based upon a four-quarter moving average ending 2021Q1.
Note: The location quotient (LQ) represents an industry's proportionate concentration in a region; an LQ greater than 1.0 means that industry employment is more concentrated in the region than nationally. A high LQ can identify industries that have a regional competitive advantage, such as the ability to produce higher quality goods more efficiently.

TO SEE INFORMATION ON TEXAS SUPPLY CHAINS AND THE TEXAS ECONOMY:
comptroller.texas.gov/economy/economic-data/supply-chain/

If you would like to receive a paper copy of ***Fiscal Notes****, contact us at* ***fiscal.notes@cpa.texas.gov****.*

ESG SPURS DIVESTMENTS IN FOSSIL FUELS

The environmental, social and governance (ESG) movement refers to the practice by investment firms and fund managers of screening investments based on preferred ethical, moral or corporate policy standards and as a way to encourage "sustainable" investment portfolios. The ESG movement precludes investments in the fossil fuels industry for designated portfolios.

"For a number of years, [ESG] was considered something akin to a Good Housekeeping Seal when someone's doing their due diligence to see if they want to make an investment or not," says Mike Reissig, chief executive officer of the Texas Treasury Safekeeping Trust Company (TTSTC), a division of the Comptroller's office. "But I think over time, the environmental side of it started taking a little more precedence."

Mike Reissig, Texas Treasury Safekeeping Trust Company

In 2022, the oil and natural gas industry employed more than 347,800 Texans, representing about 37 percent of all industry employment in the U.S., according to the Texas Independent Producers and Royalty Owners Association. The industry contributed an estimated $322 billion to the state's total gross domestic product that year, or 16 percent of the economy.

Despite the vital role of fossil fuels, in recent years executives from certain financial firms — perhaps most visibly the BlackRock Inc. investment management firm — have publicly contemplated divesting from this energy sector. (BlackRock Inc. is the world's top asset manager, with about $8 trillion of assets.) Some have taken explicit steps. HSBC Holdings, one of the 10 largest banks in the world, announced it will not finance oil and gas projects approved in 2022 onward, as part of its support for a long-term net-zero emissions goal.

Certain state and local governments also are taking formal ESG positions. In 2021, the state of Maine passed legislation requiring its public pension system to divest completely from fossil fuels companies by 2026 — holdings that currently amount to $1.3 billion. That same year, trustees from two New York City pension funds representing the city's teachers and other employees voted to divest $4 billion worth of fossil fuels industry holdings.

CHALLENGING FOSSIL FUELS BOYCOTTS

Concerned about the economic effect of ESG policies and recent moves by banks and investment firms to boycott or divest from fossil fuels, the 87th Texas Legislature passed SB 13. The bill analysis says it prohibits certain state agencies from investing funds in financial companies taking "any action that is, solely or primarily, intended to penalize, inflict economic harm on or limit commercial relations with [an energy company that] does not commit or pledge to meet environmental standards beyond applicable federal and state law."

The investment provisions of SB 13 apply to the following state entities:

- Permanent School Fund.
- Teacher Retirement System of Texas.
- Employees Retirement System of Texas, which includes the Law Enforcement and Custodial Officer Supplemental Retirement Fund and Judicial Retirement System Plans 1 and 2.
- Texas County and District Retirement System.
- Texas Municipal Retirement System.
- Texas Emergency Services Retirement System.

There are important and necessary exceptions. Notably, these agencies are not required to divest their investment holdings from financial companies identified as boycotters if doing so would obstruct the agency's fiduciary duty (its obligation to act in the best interests of state and local government employees).

The measure also prohibits state agencies and other political subdivisions of the state from entering into a contract worth $100,000 or more for goods or services with companies that actively boycott energy companies.

Texas in 2021 passed its comprehensive legislation challenging the boycott of fossil fuels by global financial companies. Others have either enacted similar boycott laws or rules curbing ESG investing with public funds (**Exhibit 1**).

"For a number of years, [ESG] was considered something akin to a Good Housekeeping Seal when someone's doing their due diligence to see if they want to make an investment or not."

– Mike Reissig

EXHIBIT 1

STATES IMPLEMENTING ENERGY BOYCOTT LAWS OR ANTI-ESG RULES

STATE	LAW/RULE	DESCRIPTION	EFFECTIVE DATE
ARIZONA	STATE INVESTMENT POLICY	*Provides that the state treasurer will not consider ESG policies when evaluating investments.*	*August 2022*
FLORIDA	SBA RESOLUTION	*Provides that the State Board of Administration will not consider ESG policies in the state's retirement system investment policy.*	*August 2022*
IDAHO	SB 1405	*Prohibits the state or its political subdivisions from considering ESG investments in a manner that could override the state's prudent investor rule.*	*July 2022*
KENTUCKY	SB 205	*Requires the state treasurer to publish, maintain and update a list of financial companies that boycott energy companies, and requires state governmental entities to divest from the listed financial companies if they do not cease boycotting.*	*April 2022*
NORTH DAKOTA	SB 2291	*Prohibits the state investment board from investing state funds based on socially responsible criteria or for purposes other than maximizing returns.*	*March 2021*
OKLAHOMA	HB 2034	*The Energy Discrimination Elimination Act of 2022 requires the state treasurer to maintain and provide to each state governmental entity a list of financial companies that boycott energy companies and requires entities to divest assets of boycotting companies.*	*November 2022*
UTAH	SB 97	*Prohibits state and local government contracts valued at $100,000 or more with corporations, limited liability companies, partnerships, majority-owned subsidiaries and affiliates engaging in economic boycotting of fossil fuels energy, among other industries.*	*March 2023*
WEST VIRGINIA	SB 262	*Authorizes the state treasurer to publish a list of financial institutions engaged in boycotts of energy companies and exclude those institutions from the selection process for state banking contracts.*	*June 2022*

Note: May not represent an exhaustive list; additional states not included in the list have proposed, but not yet passed, similar legislation.
Sources: Morgan Lewis and state legislatures' online bill search

THE COMPTROLLER'S ROLE

In Texas, the core component of SB 13 is the list of financial companies that boycott oil and gas companies, which the Comptroller's office must prepare and update. The Comptroller's office also maintains a list of specific U.S. investment funds — collective accounts (e.g., mutual funds) for which fund managers, not investors, make decisions regarding how assets should be invested — that deliberately prohibit or limit investments in fossil fuels. To compile the lists, the Legislature has authorized the Comptroller's office to use publicly available information about financial companies and investment funds and to request written verification from companies and fund managers stating they do not boycott energy.

Hegar explains that implementing SB 13 required an enormous amount of work by his staff, particularly at TTSTC. "[Developing the boycotters list] was a significant task that no one had ever done before," he says. "We had to start at square one."

But starting at square one has its advantages. Notably, it allowed the agency to develop an implementation process that aligns with Hegar's guiding principles: transparency and objectivity. He says encouraging dialogue among state officials, financial sector executives and Texans can spark intellectually honest conversations about the roles of fossil fuels and renewable energy. "Our objective is to provide a brighter spotlight on the importance of the fossil fuels industry in our everyday lives, but without disparaging alternative energy industries and their place on Texas' energy grid," says Hegar.

"Our objective is to provide a brighter spotlight on the importance of the fossil fuels industry in our everyday lives, but without disparaging alternative energy industries and their place on Texas' energy grid."

– Comptroller Glenn Hegar

EXHIBIT 2

SB 13 IMPLEMENTATION TIMELINE

JUNE 2021	SEPT. 2021	SEPTEMBER 2021-FEBRUARY 2022	MARCH 2022
Texas Governor Greg Abbott signs bill into law.	*Bill becomes effective.*	*TTSTC conducts research to draft boycott list, beginning with thousands of publicly traded companies and finishing with 19 potential boycotters.*	*Comptroller sends verification request letters to 19 financial companies seeking information about fossil fuels boycotting.*
MARCH-JULY 2022	**AUGUST 2022**	**FEBRUARY 2023**	**MARCH 2023**
TTSTC uses verification request responses from the 19 financial companies to finalize the boycott list.	*Comptroller releases boycott list consisting of 10 companies.*	*Comptroller sends letters to five state pension systems and the Permanent School Fund requesting they divest from companies on the boycott list.*	*Comptroller updates the boycott list with one additional company.*

Source: Texas Comptroller of Public Accounts

"Once we narrowed [the list] down to 19 companies, we sent [each] a follow-up questionnaire that took a deeper dive into their management's role in evaluating oil and gas investments."

– Mike Reissig

When SB 13 went into effect on Sept. 1, 2021, TTSTC began sorting through thousands of publicly traded financial services, banking and investment companies (**Exhibit 2**). Using a combination of the following resources, it initially determined 19 banks and asset managers were potentially boycotting fossil fuels:

- ***Global Industry Classification Standard*** and ***Bloomberg Industry Classification Standard*** — Widely accepted methods for grouping financial sector companies into standardized categories and subcategories to help financial market participants screen the industry's companies and their competitors.
- ***MSCI ESG Ratings Service*** — Quantitative and qualitative data that compare financial companies to their peers based on relevant ESG policies.
- ***Climate Action 100 and Net Zero Banking Alliance/Net Zero Asset Managers Initiative*** — Public commitments or pledges whereby financial companies agree to implement requirements in business decisions to further global climate goals to cut greenhouse gas emissions to near zero by a certain date, usually 2050.

"Once we narrowed [the list] down to 19 companies, we sent [each] a follow-up questionnaire that took a deeper dive into their management's role in evaluating oil and gas investments," says Reissig.

BOYCOTT LISTS

The Comptroller's office published a list of 10 financial companies found to be boycotting the fossil fuels industry last August and added HSBC Holdings this March (**Exhibit 3**). The Comptroller's office also has listed 350 investment funds determined to be boycotting the fossil fuels industry.

EXHIBIT 3

FINANCIAL COMPANIES BOYCOTTING FOSSIL FUELS

FINANCIAL COMPANY	HEADQUARTERS
BLACKROCK INC.	*United States*
BNP PARIBAS SA	*France*
CREDIT SUISSE GROUP AG	*Switzerland*
DANSKE BANK A/S	*Denmark*
JUPITER FUND MANAGEMENT PLC	*U.K.*
NORDEA BANK ABP	*Finland*
SCHRODERS PLC	*U.K.*
SVENSKA HANDELSBANKEN AB	*Sweden*
SWEDBANK AB	*Sweden*
UBS GROUP AG	*Switzerland*
HSBC HOLDINGS	*U.K.*

Note: Current as of Q1, 2023.
Source: Texas Comptroller of Public Accounts

Additional Texas Boycott Laws

Other statutes include the following:

FIREARM COMPANIES
The 87th Texas Legislature in 2021 passed SB 19 to prohibit state agencies and political subdivisions from contracting with companies endorsing discriminatory practices and policies aimed at firearm industries, including the ammunition industry, or firearm trade associations.

ISRAEL
The 85th Legislature in 2017 passed House Bill 89 to prohibit certain state agencies and political subdivisions from contracting with companies that are either actively boycotting the nation of Israel or boycotting entities or persons doing business in Israel. It directs the Comptroller's office to prepare, maintain and update a list of companies boycotting Israel, and it requires the state's public pension systems and Permanent School Fund to divest any assets of boycotting companies. As of September 2022, there were 11 companies on the list.

Sources: Texas Legislature Online and Texas Comptroller of Public Accounts

Hegar says he will continue working to "protect the Texas economy and ensure the state has a diverse energy portfolio to meet the needs of our rapidly growing state."

An entity's presence on the boycott lists does not mean it has ceased investing in fossil fuels entirely, or even plans to do so. "Because the law says a company can disadvantage oil and gas [by implementing a policy or practice] without any 'ordinary business purpose,' that company can be on the list and still invest in oil and gas," says Reissig. For example, BlackRock Inc. remains invested in Texas' public energy companies, according to testimony from the investment firm's executives; however, the firm still has made "net-zero" public pledges and employs adversarial rhetoric regarding the fossil fuels sector, among other actions that satisfy the boycotting criteria developed by the Comptroller's office.

That said, the list is not set in stone. A company or investment fund may be removed if the Comptroller's office reviews new publicly available information suggesting it no longer boycotts the fossil fuels industry.

For the listing process to be transparent, the Comptroller's office published answers to frequently asked questions (FAQs) that detail its methodology. The FAQs have been updated twice since the list first was published.

LOOKING AHEAD

The process that the Comptroller's office used to develop the boycott lists is subject to change, whether it's due to legislative directives, additional information received or a review of other relevant financial practices. "When we compile a completely new list, which we haven't done yet, we can make adjustments to the methodology," says Reissig. For example, the Comptroller's office may consider financial companies' shareholder "voting by proxy" policies in the future.

Reissig explains that investors who buy shares in a mutual fund or another product from an investment company own the shares, but the company itself is the shareholder. As the shareholder, an investment company frequently may vote on proposals affecting operations and thus investors' returns. "If the company I bought my shares through decides as the shareholder it's going to vote a certain way, it might be voting my ownership interest in a manner inconsistent with how I would have voted," Reissig says.

The Comptroller's office may update the boycott lists at any time as pertinent information becomes available. But regardless of how the lists evolve, Hegar says he will continue working to "protect the Texas economy and ensure the state has a diverse energy portfolio to meet the needs of our rapidly growing state." **FN**

Texas has come a long way in diversifying its energy portfolio. Read about current energy needs and capabilities at comptroller.texas.gov/economy/fiscal-notes/2022/sep/energy.php.

The ABCs of ESG Investing

By Moise Julot

NON-FINANCIAL MEASURES, BIG FINANCIAL IMPLICATIONS

ESG investing, or Environmental, Social and Governance investing, is an investment practice in which investors use non-financial factors in an attempt to identify investment risks and growth opportunities. Stakeholders including employees, customers, asset owners and regulators are paying close attention to the practice. In the purest form, the ESG movement aims to create greater awareness and accountability among companies and their owners about the firms' potential negative effect on third parties, such as the impact of the firms' production and consumption practices on the atmosphere, oceans and biodiversity. Such awareness, advocates suggest, will create greater incentives for firms to recognize adverse effects and develop better business practices and behaviors. Advocates include signatories to groups such as Principles for Responsible Investment, Climate Action 100+ and The Net Zero Asset Managers initiative. In other forms, ESG is used as a tool to push environmental and social agendas, or in some situations simply used as a marketing tool.

The ESG concept is a form of "stakeholder capitalism," an idea that businesses should embrace responsibilities beyond maximizing shareholder returns and take a stand on societal challenges, such as climate change and social justice issues. While the framework for targeted investment strategies was laid earlier, stakeholder capitalism originated in the 1950s and 1960s and aimed to focus on all constituents rather than shareholder interests. ESG measures claim to attempt to put a price on the risks associated with a company's effect on such things as the environment.

ENVIRONMENTAL

Looks at a company's environmental impact such as carbon emissions, pollution and waste, and potential climate change impacts. The environmental aspect of ESG has commanded much of the attention in recent years partially due to national and global climate goals, such as efforts to reduce greenhouse gas emissions, reach carbon-free electricity and achieve a net-zero emissions economy. Recent dialogue has called into question the transparency and efficacy of such goals and pledges.

SOCIAL

Considers a company's relationship with internal and external stakeholders such as a company's relationship with its workforce, suppliers, contractors and the communities in which it operates.

GOVERNANCE

Looks at corporate governance and corporate behaviors such as the diversity of a company's board, executive compensation and accounting practices.

Source: CFA Institute

EXHIBIT 1

EVOLUTION OF ESG INVESTING

PERIOD	INVESTING STRATEGY	DESCRIPTION
1920s	SOCIALLY RESPONSIBLE INVESTING (SRI)	*Strong demand for SRI products resulted in launch of values-based funds that excluded alcohol, tobacco and gambling.*
1930s	RESPONSIBLE INVESTING (RI)	*Various corporate scandals and the Great Depression increased focus on governance issues. Differing views on how to define "socially responsible" resulted in some investors dropping the S from SRI.*
1990s	SUSTAINABLE INVESTING (SI)	*An increased awareness of climate change; the term "sustainability" was introduced.*
2000s	ESG INVESTING	*The United Nations introduced its Principles of Responsible Investing in 2006, requiring the incorporation of ESG issues into the investment process; UK Pensions Act is amended in 2000 to require consideration of ESG issues in the investment process.*

Source: State Street Global Advisors

HISTORY AND EVOLUTION OF ESG INVESTING

Investment strategies that align with ethical and social considerations are not new. ESG investing represents the latest iteration.

The early motives for ESG investing were moral or ethical, based on third-party effects rather than investment returns. Socially Responsible Investing (SRI), the framework from which ESG investing evolved, began in the 1920s and entailed screening investments to exclude businesses that conflict with the investor's values. The first SRI fund, launched in 1928, restricted investing based on social issues such as tobacco, alcohol and gambling. ESG investing gained renewed interest in the mid-2000s, after then-United Nations Secretary-General Kofi Annan led the charge to develop the Principles for Responsible Investment, requiring ESG issues to be incorporated into the investment process (**Exhibit 1**).

DEMAND FOR ESG ASSETS

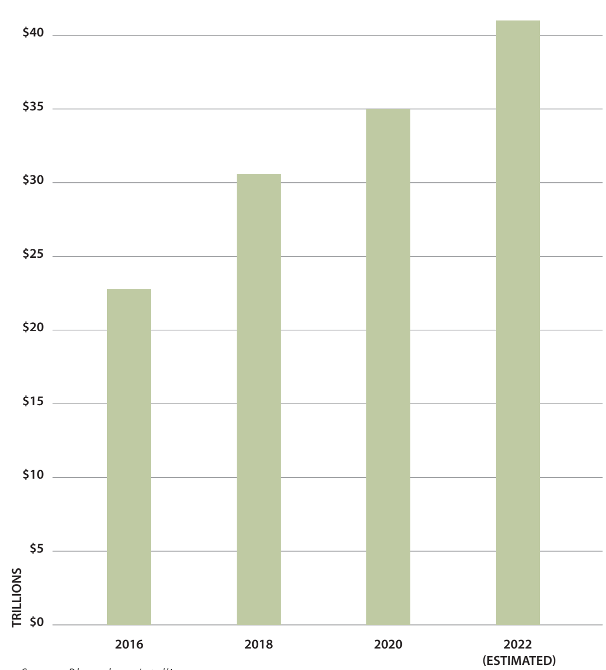
Demand for ESG assets has risen sharply in recent years. Analysis by US SIF, an industry association that represents U.S.-based institutional investors and money management firms with sustainability strategies, identified $8.4 trillion in U.S. investment assets that factor ESG policies into investment decisions, accounting for 13 percent of the total assets under management (AUM) in the U.S. market. Policies related to climate change and fossil fuel divestment were among the top priorities, comprising $3.4 trillion and $1.2 trillion, respectively. Other top concerns were avoiding investment in weapons or tobacco industries.

PricewaterhouseCoopers, one of the Big Four accounting firms, projects ESG-related global AUM to rise to $33.9 trillion in 2026 — comprising about 22 percent of the market — up from $18.4 trillion in 2021, an 84 percent increase.

By contrast, according to a January 2022 report by Bloomberg Intelligence, global ESG-related AUM totaled an estimated $41 trillion in 2022, up from $23 trillion in 2016 (**Exhibit 2**). Bloomberg estimates that ESG assets could exceed $50 trillion by 2025, accounting for one-third of global AUM.

EXHIBIT 2

GLOBAL ESG ASSETS UNDER MANAGEMENT (2016-2022)



Source: Bloomberg Intelligence

After its *2020 Trends* report, the US SIF modified its methodology for the 2022 report. The changes exemplify the difficulties in measuring and defining ESG and reporting issues regarding ESG assets. The US SIF report identified a steep decline in U.S. ESG-related AUM from $17.1 trillion in 2020 to $8.4 trillion in 2022. Some of this drop was due to overall declines in financial markets, but the most likely cause was increased regulatory pressure from the U.S. Securities and Exchange Commission (SEC), which cracked down on misleading ESG claims, a move that resulted in firms withdrawing their sustainability funds. The US SIF report says that "these SEC proposals are motivating asset managers to be more circumspect in what they consider to be assets that incorporate ESG criteria." Efforts by some Republican elected officials also may be contributing to a declining appetite for these investments, in showing that much of ESG is in many ways more of a marketing tool than an investment tool.

GREENWASHING RISK

ESG is an all-inclusive phrase for a "broader" viewpoint on stakeholder interests beyond shareholder interests, according to Sehoon Kim, assistant professor in the Department of Finance, Insurance and Real Estate in the Warrington College of Business at the University of Florida. "Stakeholders, by definition, are a broad group of parties with diverging interests regarding the company's policies. As such, ESG is inherently difficult to pin down with a narrow definition or to measure with accuracy. This is perhaps the biggest ongoing challenge for ESG investing."

Sehoon Kim, Warrington College of Business at the University of Florida

Kim emphasizes, "As with any issue that is open to interpretation and [subjectivity], there is widespread concern that ESG [measures are] also prone to manipulation ['greenwashing'] precisely given these measurement challenges." Kim continues, "This challenge is exacerbated by the fact that firms currently face ever greater pressure from stakeholders and stronger incentives to cater to them, despite the fact that it is difficult to determine exactly whom to cater to and how to do so."

The lack of a universal definition of what constitutes ESG standards, along with inconsistent performance measures, raises significant concerns of "greenwashing." Corporate greenwashing exists when brands target environmentally and socially conscious consumers by making exaggerated claims or misleading statements to convince the consumer to buy a product. Likewise, a working paper by the Rock Center for Corporate Governance at Stanford University says that a "fund manager engages in greenwashing when it advertises its investment funds as sustainable without engaging in a rigorous process to evaluate ESG quality." A report by the American Council for Capital Formation points to disclosure limitations and the lack of standardization, company size bias, geographic bias, industry sector bias, inconsistencies among rating agencies, and failure to identify risk as reasons why disparities exist among firms in the accuracy, value and importance of ratings.

For this reason and others, ESG investing practices are receiving pushback from a number of federal and state policymakers. "The ESG movement has produced an opaque and perverse system in which some financial companies no longer make decisions in the best interest of their shareholders or their clients, but instead use their financial clout to push a social and political agenda shrouded in secrecy," says Texas Comptroller Glenn Hegar, whose office is responsible for implementing a 2021 law that requires it to identify financial firms that boycott certain energy companies. (For more information on anti-ESG legislation in Texas and other states, see accompanying article.)

ENHANCED REGULATORY PRESSURE

Companies and investment firms using ESG factors as a marketing tool to capitalize on the often personal aspect of ESG investing is a growing concern. For example, Germany's Deutsche Bank asset management brand, DWS, made headlines in June 2022 when its chief executive said he would resign following allegations of greenwashing. According to Reuters, German prosecutors said at the time that "'sufficient factual evidence has emerged' to show that ESG factors were taken into account in a minority of investments 'but were not taken into account at all in a large number of investments,' contrary to statements in DWS fund sales prospectuses."

In March 2021, the SEC launched the Climate and ESG Task Force to "develop initiatives to proactively identify ESG-related misconduct consistent with increased investor reliance on climate and ESG-related disclosure and investment."

A risk alert by the SEC's Division of Examinations acknowledges concern in the ESG rating industry, stating that the "rapid growth in demand, increasing number of ESG products and services, and lack of standardized and precise ESG definitions present certain risks." The SEC risk alert goes on to state that "the variability and imprecision of industry ESG definitions and terms can create confusion among investors if investment advisers and funds have not clearly and consistently articulated how they define ESG and how they use ESG-related terms, especially when offering products or services to retail investors." A number of policymakers pushing back on ESG investing contend the SEC, rather than promulgating rules regarding ESG practices, should instead focus on financial rules and regulations. SEC Commissioner Hester Peirce, similarly, saw a "coercive trend" to promote ESG investing in a May 2022 SEC proposal to enhance companies' disclosure of their ESG strategies. Peirce, one of five SEC members, asked, "Why do we feel compelled to propose such sweeping and prescriptive new rules when we can and do use existing rules to hold funds and advisers to account?"

Many investors applying ESG investing criteria rely heavily on ESG scores provided by ESG rating firms. The scoring of the ESG rating firms, however, is based on unregulated data, and the scoring system can be wildly inconsistent with little clarity on agencies' methodologies. According to *The Economist*, for example, a study of six ESG rating firms discovered they used 709 different metrics across 64 categories, and just 10 categories were common among all. Moreover, *The Economist* reports that credit-rating agencies like Moody's and S&P Global produce results that are 99 percent correlated, whereas ESG rating firms show correlations only 50 percent of the time. This suggests that results produced by ESG ratings firms only agree half of the time. Market participants using credit ratings and ESG scores must work to understand these differences. For example, Texas' credit rating was rated AAA by Fitch, S&P Global, Moody's and KBRA. Each firm, however, handles ESG differently. KBRA does not offer subjective ESG scoring products while Moody's does. Moody's integrates ESG profile scores into the published credit analysis and graphically highlights the ESG scores more than the state's AAA credit rating.

HIGHER FEES FOR MEAGER RETURNS

According to research in the journal *Review of Accounting Studies*, "ESG funds appear to underperform financially relative to other funds within the same asset manager and year, and to charge higher fees." A similar study surveying more than 1,100 peer-reviewed papers and meta-reviews published between 2015 and 2020 suggested when comparing the financial performance of ESG investing against other investments, "the financial performance of ESG investing has on average been indistinguishable from conventional investing." Yet, ESG fund managers "typically charge fees 40 percent higher than traditional funds," according to an article in *Harvard Business Review*.

The U.S. Department of Labor's (DOL) November 2022 interpretation of the Employee Retirement Income Security Act of 1974 (ERISA) — which said ESG factors could be considered in making decisions about retirement investments — was opposed by officials concerned that ESG investing places social agendas ahead of fiduciary duties. The sentiment was echoed by Hegar: "Fund managers will be free to consider climate change and other ESG factors rather than aiming to deliver the highest possible returns for American retirees. … These retirees will see their hard-earned dollars diminish as ESG funds fail to deliver promised returns while simultaneously charging higher fees, even as the value of their remaining dollars purchases less due to inflation."

The U.S. Congress in March repealed the November 2022 DOL ruling, but the repeal was subsequently vetoed by President Joe Biden.

Texas Comptroller Glenn Hegar speaks at The Bond Buyer*'s Texas Public Finance conference on Thursday, April 13 in Austin.*

MORE THAN MEETS THE EYE

Texas leaders including Hegar have expressed worry over what ESG policies could mean for the oil and gas industry, which encompasses more than just motor oil, heating for the home or electric power generation. According to the U.S. Department of Energy, petrochemicals derived from oil and natural gas make possible the manufacturing of more than 6,000 everyday products and high-tech devices. The extensive list ranges from car parts to eyeglasses, from ballpoint pens to laptops and from fertilizers to footballs.

"Exclusion-based ESG investing strategies undoubtedly have negative impacts on oil and gas businesses, as they raise the cost of capital for companies in these industries," Kim says. However, Kim adds that "oil and gas companies are also among the most innovative when it comes to developing greener technologies," such as high quality "green patents" (patents related to environmental technology). In a National Bureau of Economic Research paper, researchers find that "the incremental green patent is significantly more likely to come from energy firms than any other type of firm, including highly rated ESG firms that are producers of green patents."

MOVING FORWARD

Texas has a diverse energy portfolio. Not only is Texas the top crude oil and natural gas producer in the nation, but it also leads the nation in wind-powered electricity generation and produces more electricity than any other state. Hegar says this diversity is important and that an "intellectually honest conversation" highlighting transparency, fiduciary responsibilities and the continued economic strength of Texas is a necessary step: "We need to make sure we have a balance in use of energy, that we also are taking care of the environment and that we keep our focus on the fundamentals that are so important to the economy." **FN**

Learn more about the state's investments through the Texas Treasury Safekeeping Trust Company at comptroller.texas.gov/transparency/budget/investments.php.

State Revenue Watch

This table presents data on net state revenue collections by source. It includes most recent monthly collections, year-to-date (YTD) totals for the current fiscal year and a comparison of current YTD totals with those in the equivalent period of the previous fiscal year. These numbers were current at press time. For the most current data as well as downloadable files, visit **comptroller.texas.gov/transparency**.

Note: Texas' fiscal year begins on Sept. 1 and ends on Aug. 31.

NET STATE REVENUE – ALL FUNDS, EXCLUDING TRUST

Monthly and Year-to-Date Collections: Percent Change from Previous Year
(IN THOUSANDS)

TAX COLLECTIONS BY MAJOR TAX	APRIL 2023	YEAR TO DATE: *Total*	YEAR TO DATE: *Change from Previous Year*
SALES TAX	$4,087,704	$30,846,608	10.34%
Percent Change from April 2022	6.71%		
MOTOR VEHICLE SALES AND RENTAL TAXES	$506,800	$4,341,554	8.40%
Percent Change from April 2022	-3.48%		
MOTOR FUEL TAXES	$318,680	$2,509,440	0.52%
Percent Change from April 2022	-4.87%		
FRANCHISE TAX	$820,525	$1,136,343	18.47%
Percent Change from April 2022	-0.15%		
OIL PRODUCTION TAX	$452,534	$4,040,474	6.77%
Percent Change from April 2022	-32.01%		
INSURANCE TAXES	$16,119	$2,426,051	34.10%
Percent Change from April 2022	33.65%		
CIGARETTE AND TOBACCO TAXES	$91,130	$758,378	-3.50%
Percent Change from April 2022	-10.03%		
NATURAL GAS PRODUCTION TAX	$202,929	$2,766,205	8.05%
Percent Change from April 2022	-40.16%		
ALCOHOLIC BEVERAGES TAXES	$163,130	$1,162,518	11.06%
Percent Change from April 2022	7.46%		
HOTEL OCCUPANCY TAX	$83,487	$494,111	17.24%
Percent Change from April 2022	9.15%		
UTILITY TAXES[1]	$69,003	$369,819	19.98%
Percent Change from April 2022	8.52%		
OTHER TAXES[2]	$38,989	$194,933	52.18%
Percent Change from April 2022	76.56%		
TOTAL TAX COLLECTIONS	**$6,851,029**	**$51,046,433**	**10.34%**
Percent Change from April 2022	**-1.35%**		

REVENUE BY SOURCE	APRIL 2023	YEAR TO DATE: *Total*	YEAR TO DATE: *Change from Previous Year*
TOTAL TAX COLLECTIONS	$6,851,029	$51,046,433	10.34%
Percent Change from April 2022	-1.35%		
FEDERAL INCOME	$5,123,687	$47,513,548	5.12%
Percent Change from April 2022	-2.01%		
LICENSES, FEES, FINES AND PENALTIES	$431,488	$4,371,517	1.21%
Percent Change from April 2022	-6.75%		
STATE HEALTH SERVICE FEES AND REBATES[3]	$468,039	$7,625,742	46.18%
Percent Change from April 2022	-17.75%		
NET LOTTERY PROCEEDS[4]	$270,840	$2,204,030	12.67%
Percent Change from April 2022	22.70%		
LAND INCOME	$238,182	$2,731,010	7.81%
Percent Change from April 2022	-31.49%		
INTEREST AND INVESTMENT INCOME	$261,902	$2,374,177	73.78%
Percent Change from April 2022	82.24%		
SETTLEMENTS OF CLAIMS	$84,856	$557,203	-11.22%
Percent Change from April 2022	-6.71%		
ESCHEATED ESTATES	$15,734	$119,472	-3.79%
Percent Change from April 2022	-5.43%		
SALES OF GOODS AND SERVICES	$23,067	$194,617	-4.05%
Percent Change from April 2022	10.93%		
OTHER REVENUE	$196,970	$1,121,156	-22.22%
Percent Change from April 2022	36.97%		
TOTAL NET REVENUE	**$13,965,794**	**$119,858,905**	**9.71%**
Percent Change from April 2022	**-1.57%**		

1. Includes public utility gross receipts assessment, gas, electric and water utility tax and gas utility pipeline tax.

2. Includes taxes not separately listed, such as taxes on oil well services, coin-operated amusement machines, cement and combative sports admissions as well as refunds to employers of certain welfare recipients.

3. Includes various health-related service fees and rebates that were previously in "license, fees, fines and penalties" or in other non-tax revenue categories.

4. Gross sales less retailer commission and the smaller prizes paid by retailers.

Notes: Totals may not add due to rounding. Excludes local funds and deposits by certain semi-independent agencies. Includes certain state revenues that are deposited in the State Treasury but not appropriated.

FISCAL NOTES

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