The Daily Dish

ESG in the Spotlight

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Today the House Financial Services Committee will hold a hearing entitled "Protecting Investor Interests: Examining Environmental and Social Policy in Financial Regulation." Environmental, social, and governance (ESG) policies have become a hot-button issue in the financial services industry. The committee memo argues:

"The federal government's focus on costly non-material environmental, social, and political issues at the expense of sound financial regulation has troubling consequences. This approach significantly drives up the costs and burdens associated with participating in the U.S. public markets, leading to decreased attractiveness for private companies considering going public or remaining public."

This is consistent with a recent past in which elected officials at state and federal levels have increasingly called for financial services firms to cease what they see as aggressive ESG policies. We have even seen some states prohibiting themselves from contracting with banks and asset managers with ESG policies, removing state funding from these firms, or reinvesting state pension policies.

Stepping back, it is unsurprising that the potential for conflict arises. Private firms are run by their shareholders and should pursue policies that their owners prefer. This may include ESG goals or investments with ESG considerations. In the same way, public-sector officials must pursue the policies favored by voters. This may include forbidding taxpayer money to be used by firms with ESG objectives. These considerations may simply not be able to coexist.

What is surprising is that conservatives no longer view their role as protecting the private sector from undue governmental interference and allowing private firms to pursue whatever goals they may have. The use of the power of the state to punish private firms for having "incorrect" goals and beliefs is a new and undesirable development.

It is also surprising that participants in the debate are unwilling to acknowledge the existence of basic tradeoffs. For private investors, weighing ESG factors into the mix may reduce the final return on investment, but that is something one can do with one's own money. But for private investment managers, there is a fiduciary responsibility to get the highest possible return; any ESG concerns must be consistent with meeting that responsibility. For states and other government entities, deciding not to do business with firms for ESG (or any other) reasons means having fewer competitors for government business and paying a higher price for services purchased with taxpayer money.

As Thomas Kingsley concluded in his piece on the issue: "Capitalism at its core is based on the benefits provided by market incentives. The appropriate role of government should be to encourage the growth of companies in providing the products and services to whatever interest groups are determined by shareholder demand. Instead, increasingly strident demands from either end of the political spectrum seek to tell financial firms what products they should offer, and to whom."

Amen.