

C O M M E N T

ESG IS INVESTMENT STRATEGY

by Anne Kelly

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The authors' article, *Do ESG Mutual Funds Deliver on Their Promises*, is a timely and insightful piece with several important conclusions. I have three principal observations to add to the commentary on the paper: (1) Securities and Exchange Commission (SEC) regulations that would require stricter definitions and more robust disclosure are important for the health and legitimization of the ESG market; (2) climate risk is financial risk—investors want to make money, and the ESG market is providing them with an opportunity to do so; and (3) despite the positive results identified by studies like that conducted by Curtis et al., at the state level, several problematic bills have been passed to restrict investment practices by prohibiting the consideration of ESG and other factors, and these bills are projected to cost taxpayers millions of dollars. I address these points below.

First, robust disclosure is essential for the decisionmaking of investors, and enhanced climate risk disclosure will enhance the ESG market by allowing investors to understand the nature of climate risk and make decisions accordingly. There is an important distinction between the valuable disclosure requirements that are emerging from the SEC and the efforts to regulate ESG by state legislatures that I mention below. Informing investors is critically important given that the area of ESG investing is growing and evolving rapidly. Heightened transparency would help fortify the role of ESG investing, and the SEC's proposed regulations take an important step in that direction. They should be finalized quickly and without watering down the core climate risk and greenhouse gas disclosure provisions.

Second, several experienced investors have spoken on the topic of ESG investing and have emphasized that climate risk is investment risk. Investors strive to make profitable returns and must consider the long-term impacts of

their investments. They use investment strategies and make decisions that revolve around prudent risk management and opportunity optimization. Thus, as climate change worsens and the marketplace shifts in response to climate and related risks, investors can be expected to increase their interest in the investment opportunities offered by ESG funds.

Third, despite the favorable performance of ESG funds identified in the Curtis et al. study and the growing importance to investors of climate change and the energy transition, ESG opponents have introduced roughly 140 bills in state legislatures this year that would limit state investment practices by prohibiting the consideration of non-pecuniary factors. Many of these bills appear to target ESG factors in particular. They miss the mark because, as I noted above, climate risk and financial risk are inherently intertwined and climate risk can only be expected to grow. Legislators are increasingly realizing that ESG investing is risk-based investing, though, and Ceres is leading an initiative called "Freedom to Invest," which points out that politicians should not be telling investors what considerations they should include in their private investment decisions and state pensioners should not be losing their retirement funds because of the politicians' preferences. Fortunately, many of the ESG restriction efforts have been scuttled amid revelations about the millions of dollars in additional taxpayer costs that would arise from these policies.

In short, the Curtis et al. paper is an important contribution to our understanding of the importance and effects of ESG investing. Policymakers at the federal and state levels would do well to allow financial disclosure to do what it does best: enable investors to make informed choices to reduce financial risk, which these days must include climate risks.

Editors' Note: Anne Kelly's Comment is based on an edited transcription of her remarks at the Environmental Law and Policy Annual Review conference. See 2022-2023 Environmental Law and Policy Annual Review Conference, available at <https://www.eli.org/environmental-law-and-policy-annual-review>.