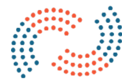
National Caucus of Environmental Legislators

Climate Finance Briefing Book



NCEL
National Caucus of Environmental Legislators

202.744.1006 • www.ncelenviro.org • 1100 H St NW, Suite 600 • Washington, DC 20005

Acknowledgments: *NCEL is grateful for the support and expert knowledge of the following organizations during the creation of this briefing book: Pleiades Strategy and The Sunrise Project.*

Table of Contents

Introduction ..... p. 3

Section 1 - Understanding Climate Financial Risks ..... p. 4

Section 2 - State Attacks & Opportunities on Climate Finance ..... p. 6

Section 3 - Specific Levers for Policy ..... p. 8

- 3.1 Contracts ..... p. 8
- 3.2 Pensions ..... p. 10
- 3.3 Liabilities & Disclosures ..... p. 12
- 3.4 Insurance ..... p. 14

Section 4 - Case Study: Arizona's Success Fighting Anti-ESG Legislation ..... p. 16

An Introduction to Climate Finance

In October 2021, the Financial Stability Oversight Council (FSOC) issued a report concluding that climate change poses an "emerging and increasing threat to U.S. financial stability," and directed FSOC's member regulatory agencies to institute climate financial regulations. The report comprises a climate risk supervision framework, including standards for corporations to disclose climate risk to investors and regulatory rules requiring banks and other financial institutions to measure their exposure to climate risks.

Many aspects of state finances, including budgets and pensions, are exposed to climate risk. State policymakers have a range of tools and policies available that can reinforce the federal climate risk supervision framework and shield constituents from the economic threats of climate change. State governments have tremendous economic power that can be a force for shaping financial market outcomes.

Over the last 15 years, the economy has seen increasing interest in environmental, social, and good governance (ESG) standards as tools to enable sound risk management assessments. Financial institutions utilize ESG standards to evaluate a company's risks when making investment decisions. ESG investing has also been a useful risk management tool for state treasurers and other public pension fund managers. Broadly, ESG investing aims to value ethical and responsible activity and considers how liability risks from corporate governance are relevant to the long-term value of firms within the portfolio. Accounting for climate risks is an important component of ESG standards and helps strengthen investment outcomes, bringing greater returns back to communities.

In recent years, there has been a push to oppose ESG and climate investing through state legislation, with an increase in bills proposing the restriction of financial managers' ability to take communities and the environment into account in their decisions. Last year, such bills were pushed in 37 states. Some form of restriction on ESG risk analysis and investment is now law in 17 states.

Briefing Book Overview: This briefing book provides more information and policy options for various aspects of climate finance policy including: 1. understanding climate financial risks, 2. state attacks and opportunities on climate finance, 3. specific policy levers to address climate financial risks, and 4. Arizona's success fighting off anti-ESG legislation.

NCEL Climate Finance Briefing Book

Section 1

Understanding Climate Financial Risks

Overview

Corporations disclose potential risks to allow investors to adequately perform risk management and improve the overall strength and stability of the financial system. Climate change provides huge financial risks. As investors make financial decisions, they must acknowledge the physical risks of climate change as well as the state, federal, and global efforts to transition to a low-emission economy. The chart below gives examples of how climate risks impact financial risks.

Type of Risk	Description	Example
Credit Risk	The potential that a borrower cannot repay the amount owed.	A borrower has a decreased cash flow because money was spent repairing materials from a wildfire.
Liquidity Risk	Assets cannot easily be converted to cash to pay debts.	The market for green bonds booms. The issuers of non-green bonds are still going to repay lenders, but those holding these bonds must hold them until maturity. Thus, the non-green bonds are less liquid.
Market Risk	The risk of losses on financial investments due to changes in price.	If the government decided to tax carbon, stock prices in fossil fuel companies would fall.
Operational Risk	The risk of losses caused by flawed processes, policies, systems, or events that disrupt business operations.	Extreme weather may close offices or data centers.

Figure 1: *Chart outlining different types of financial risks and how climate change impacts those risks. Source: Federal Reserve Bank of Chicago.*

Assessing Climate Financial Risks

Frameworks for assessing climate risks have spread across the globe and the country.

On the global level, the U.S. launched the U.S. International Climate Finance Plan in 2021. This plan works to increase international public climate finance to over $11 billion annually, with the U.S. specifically contributing to multilateral development banks. More pertinently, head federal agencies are working towards private sector mobilization related to climate-smart investments globally.

Domestically, the Department of Treasury has pushed guidance, the Principles for Climate-Related Financial Risk Management for Large Financial Institutions, encouraging financial institutions to develop strategies and capacity to identify, measure, and control for climate-related risks. The Office of the Comptroller of the Currency (OCC) performed a climate risk assessment of 20 banks to determine the impact of climate change on their business. From here, the OCC created a baseline of practices to determine progress in the implementation of future guidance. The Federal Insurance Office put forth a report outlining how state insurance regulators and policymakers can integrate climate risk into regulation of insurance companies so that insurance companies remain solvent even as costs from climate disasters continue to grow.

NCEL Climate Finance Briefing Book

Section 2

State Attacks and Opportunities on Climate Finance

Attacks on Climate Financial Risks

The anti-ESG campaign is in part inspired by a form of climate denial and an interest in insulating fossil fuel companies from the consequences of the climate crisis. Supporters of the anti-ESG campaign have sought to ban the consideration of climate risk by pension trustees, financial institutions, and state officials through various legislative trends, such as contracts, disclosures, pensions, and insurance. Since 2021, legislators in 39 states have considered 373 pieces of legislation attacking ESG; only 42 became laws in 19 states. Below is an example of the language used in a model bill:

> **Bill Language to Watch For:** "This bill would prohibit the consideration of environmental, social, and governance (ESG) criteria when awarding a public contract and would require a responsible bidder, as a condition of being awarded a public contract, to certify, under penalty of perjury, that its employees will not be subject to a personal ESG rating as a basis of hiring, firing, or evaluation."

This effort prevents the ability of financial institutions to effectively plan for the risks that are proven without a doubt to increase in frequency and severity. As such, it generated massive backlash from Democrat and Republican politicians, the business community, labor leaders, retirees. It is not an issue that resonates with the public.

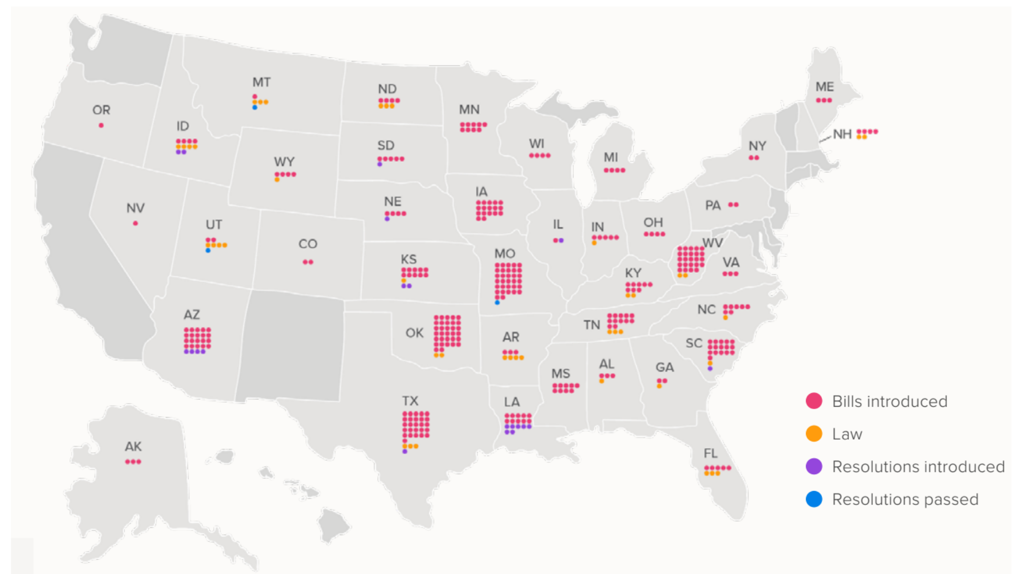


Figure 2: *Map of 373 Anti-ESG legislative proposals to date. Source: Pleiades Strategy.*

Opportunities for State Action

States have great authority to create healthy and resilient financial systems, combat anti-ESG efforts, and ensure the impact of climate is considered. As states transition to a net-zero economy, it is their duty to capitalize on new opportunities and mitigate harms that will impact state and private investments.

As indicated in President Biden's U.S. Climate-Related Financial Risk Executive Order 14030: "By sustaining the status quo, we not only face the mounting repercussions of climate change, but also bear the opportunity cost of missing out on an historic chance for job creation, shared prosperity, and a more resilient future."

The federal government is using a whole-of-government approach to incorporate climate risk into financial planning, but states have unique authority over insurance, pension investing, green banks, and corporate disclosures in their own right. Without proper consideration of the hidden and underestimated risks from climate change, the growing potential for business disruptions, productivity loss, and bankruptcies is obscured, and American families are left vulnerable to an unprepared and fragile economic system.

See each state's pending and enacted legislation on the Ropes & Gray website.

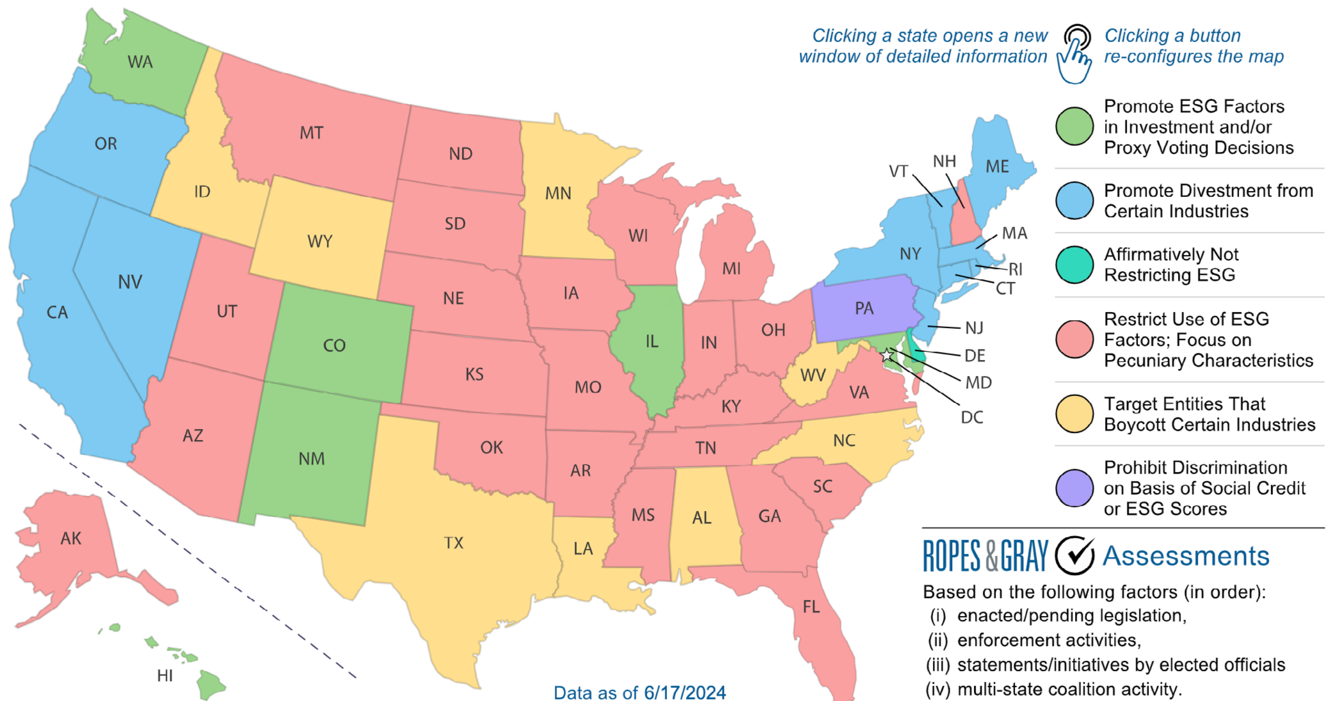


Figure 3: *Map of state-level policy approaches for regulating ESG. Source: Ropes & Gray.*

Putting Policy Into Action: The following section provides a closer look at the threats, opportunities, and policy options across four levers for climate finance policy: (1) Contracts, (2) Pensions, (3) Liabilities & Disclosures, and (4) Insurance.

NCEL Climate Finance Briefing Book

Section 3

Specific Levers for Policy

CONTRACTS

The Threat to Contracts

Anti-ESG policies promulgated through contract legislation bans the state from contracting with businesses that "boycott" or "discriminate against" certain industries. This type of legislation typically targets companies who boycott investments in fossil fuels, mining, agribusiness, timber or firearms. Many anti-ESG contracting bills direct a state authority to create a blacklist of financial institutions engaging in discrimination or boycotts and then subsequently ban the state from contracting with institutions taking such actions.

Bill Language to Watch For

- **"a governmental entity** may not enter into a contract with a company for goods or services unless the contract contains a written verification from the company that it:

  i) does not engage in economic boycotts; and

  ii) will not engage in economic boycotts during the term of the contract."

- **"empowers state attorneys general** to investigate 'any person, company, or financial institution found to be... restrain[ing] the trade or commerce of energy companies…'"

Impacts on States

Both Texas and Oklahoma passed restrictive contract legislation in recent years, bearing poor outcomes.

Texas: After Texas passed its anti-ESG laws, some of the largest bond dealers were forced from the market. It's estimated that this has led to an additional cost of $700 million in interest payments on municipal bonds.

Oklahoma: In Oklahoma, the city of Stillwater was set to borrow $13.5 million from Bank of America for city improvements. But after the contracting legislation was passed and Bank of America made the "blacklist," the city's next best option was $1.2 million higher.

State Action on Contracts

Instead of banning financial actors in a state from engaging with certain companies, legislators can choose to prioritize work and investment with companies who have strong ESG practices. New York has some of the strongest emission reduction targets and labor/equity standards in the country created by their Climate Leadership and Community Protection Act (CLCPA). Through introduced legislation in 2024, the Senate Banking Committee worked to bring the purchasing of bank services in line with these ambitious goals.

Legislation

- **New York S.9758 (introduced 2024):** Creates standards for the purchasing of bank services by state agencies including:

NCEL
National Caucus of Environmental Legislators
202.744.1006 • www.ncelenviro.org • 1100 H St NW, Suite 600 • Washington, DC 20005

» requiring banks with over $100 billion in assets to disclose their greenhouse gas emissions, clean energy financing ratio, and policies related to fossil fuels,

» considering these factors as components of “best value” when state agencies select banks for services such as credit cards, processing, and depository services,

» prohibiting the state from contracting with banks that have not disclosed their scope 1, 2, and 3 emissions by 2026.

Additional Resources

- **2024 Statehouse Report** | ***Pleiades Strategy***

PENSIONS

Overview of Pensions

U.S. public pension funds manage an estimated $5.6 trillion in assets on behalf of workers who depend upon their pensions for a secure retirement. The solvency of public pensions is critical for the ability of Americans who have dedicated their lives to public service to retire with dignity. For state-sponsored retirement systems, governance typically involves the governor, legislature, retirement system board of trustees, and staff to whom the board has delegated administrative responsibility.

The Threat to Pensions

Anti-ESG legislation has made efforts to control the ability of pension managers to effectively address financial risk to public pension funds holding the future of millions in uninformed hands.

Bill Language to Watch For

- **"Financial' does not include** any action taken, or factor considered, by a fiduciary with any purpose whatsoever to further social, political, or ideological interests."
- **"In making and supervising investments** of the reserve fund of a public retirement system, an [investment manager] [fiduciary] or [the governing body] shall discharge its duties solely in the financial interest of the participants and beneficiaries for the exclusive purposes of:

  i) providing financial benefits to participants and their beneficiaries; and

  ii) defraying reasonable expenses of administering the system."

These bills work to preclude pension managers from considering risks that are "systemic" or "involve a high degree of uncertainty regarding what may or may not occur in the distant future," both of which directly apply to climate risks. As pensions are managed for the long term such risks are critical to take into account. At least 12 states have passed such legislation as of 2024, raising pension system costs and threatening returns. This affects the ability of teachers, firefighters, and policemen to retire.

Additional Resources

- **Anti-ESG Legislation — Why it Matters and What States Can Do** I ***Climate XChange***
- **States shrug off warnings, plow ahead with anti-ESG laws** I ***E&E News***

State Action on Pensions

The strongest way for states to protect pension funds from climate risk and respond to the costly attacks on ESG investing is to define systemic risks like climate change, and declare it to be in the interest of the state government and public pension fund beneficiaries to mitigate exposure to those risks. Several states have begun to define systemic risk factors that are required and to require disclosure of how those factors are being taken into consideration. States have also begun to require assessments of the state's exposure to systemic risks, and have begun integrating those assessments into the proxy voting practices that determine how the state engages in corporate shareholder meetings.

Legislation

- **Colorado S.B.23 16 (enacted 2023):** Requiring the state's retirement system to report information about climate risks and strategies every year.
- **Maine L.D.99/H.P.65 (enacted 2021):** Requires state agencies — the Treasurer's Office and the Maine Public Employees Retirement System — to divest from all fossil fuel holdings by 2026.

- **Minnesota S.F.4859/H.F.4790 (introduced 2024):** Requires the Minnesota State Board of Investment to implement a sustainable investment policy including: corporate governance and leadership factors, environmental factors, social factors, and human capital factors; by 2025, the state board must annually report process for identifying climate change-related risks and assessing the financial impact that those risks have on the state board's operations.

- **Illinois H.B.2782 (enacted 2023):** Establishes that every investment manager who manages public funds in the state (including pensions) must comply with new disclosure rules that require the investment manager to prudently integrate sustainability factors into their investment decision-making, investment analysis, portfolio construction, due diligence, and investment ownership.

- **Maryland H.B.0740/S.B.0566 (enacted 2022):** Requires the Maryland State Retirement and Pensions System to identify climate risks, determine investment opportunities in emerging technologies, wean the state off of fossil fuel investments, and establish policies to implement and report on these practices.

Additional Resources

- **ESG and Public Pension Investing in 2023** I ***Ropes & Gray***

- **State Pension Funds and Climate Risk: A Roadmap for Navigating the Energy Transition** I ***The Roosevelt Institute***

- **The Emperors' New Climate Scenarios** I ***Institute of Faculty of Actuaries/University of Exeter***

LIABILITIES & DISCLOSURES

The Threat to Liabilities & Disclosures

Disclosure legislation differs from contracts and pensions by targeting the ability of private sector decisions between financial firms and the companies and individuals they do business with. Essentially, the legislation restricts the ability of financial managers to consider the full range of risks when evaluating the bankability or credit-worthiness of individuals and businesses.

Bill Language to Watch For

- **"A credit union** may not deny membership, a loan, or services to a person that meets the scope and field of membership for that credit union based solely on subjective measures such as environmental, social, and governance criteria; diversity, equity, and inclusion policies; or political and ideological factors without actual notice delivered to the person of the measures, criteria of factors used in making that determination."

- **"A financial institution** that uses standards or guidelines based on nonfinancial, nontraditional, and subjective measures such as environmental, social, and governance criteria; diversity, equity, and inclusion policies; or political and ideological factors shall: Disclose to the commissioner of financial institutions the standards, guidelines, and criteria used by the financial institution to determine access to or denial of a financial product or service to a person in this state."

The legislation calls these targeted criteria "any "nonfinancial, nontraditional, and subjective measures," which includes ESG factors and Diversity, Equity and Inclusion (DEI) metrics. As of June 2023, no state has passed this legislation but two states have passed bills through one legislative chamber.

Additional Resources

- **Anti-ESG Legislation — Why it Matters and What States Can Do** I ***Climate XChange***
- **ESG Battlegrounds: How the States Are Shaping the Regulatory Landscape in the U.S.** I ***Harvard Law School Forum on Corporate Governance***

State Action on Liabilities & Disclosures

California led the charge on mandating climate risk and greenhouse gas emissions in corporate disclosures in a package of 2023 bills. The legislation notes that the impacts of climate change, such as wildfires, sea level rise, extreme weather events, and extreme droughts, are affecting California's communities and economy. Failure of corporations to consider these impacts will result in significant harm to the state. New York and Washington state have since followed in the footsteps of California, looking to model their own policy with introduced legislation.

By including climate impacts in corporate disclosures, states are acknowledging that climate risks can be financially "material" — and that when they are, they must be reported like any other risk to a company's bottom line. When corporations are required to report on their climate risk, they are better able to identify and respond to the specific aspects of their business model that are impacted.

Legislation

- **California S.B.253 (enacted 2023):** Requires both public and private US businesses with revenues greater than $1B USD doing business in California to report their emissions comprehensively, including scopes 1, 2, and 3, beginning in 2026 (for 2025 data).

- **California S.B.261 (enacted 2023):** Requires large US businesses with annual revenues over $500M USD operating in California to bi-annually disclose climate-related financial risks and their mitigation strategies to the public.

- **New York S.897B (introduced 2023):** Establishes the climate corporate data accountability act requiring certain business entities within the state to annually disclose scope 1, scope 2 and scope 3 emissions; establishes the climate accountability and emissions disclosure fund.

- **Washington S.B.6092 (passed Senate 2024):** Directs the Washington Department of Ecology to develop policy recommendations to address climate-related disclosure requirements in the state.

Additional Resources

- **Corporate Climate Disclosure Has Passed a Tipping Point. Companies Need to Catch Up | *WRI***

INSURANCE

The Threat to Insurance

Insurance is a key channel through which climate risk is transmitted through the financial system, and it is almost entirely regulated at the state level. Insurance laws are passed by state legislators, signed into law by governors, and implemented by state insurance regulators, who also adopt and enforce regulations and guidance for insurers domiciled or doing business within their states.

As storms become stronger and wildfires more frequent, insurance has become more expensive and less available, leaving many homes and property unprotected. Increased risk from climate-induced natural disasters has even prompted some high-profile insurance companies to stop writing new policies in certain climate-vulnerable regions.

Despite the need for insurance companies to consider climate risk more than ever, some states are pushing in the opposite direction. In 2023, Texas was the first state to ban insurance companies from using ESG standards in rate setting. By prohibiting the use of environmental standards in rate setting, the state is making the already fragile market even more volatile.

Bill Language to Watch For

"An insurer may not use an environmental, social, or governance model, score, factor, or standard to charge a rate different than the rate charged to another business or risk in the same class for essentially the same hazard."

State Action on Insurance

The Treasury Department's Federal Insurance Office (FIO) has issued 20 recommendations for how state policymakers can integrate climate risk into state insurance regulation. Adopting these recommendations can help state leaders make insurance markets healthier and more resilient. These recommendations can also help state leaders protect their constituents from the worst consumer hazards.

As mounting costs from climate disaster places pressure on state budgets and disrupt housing and insurance markets, many states have sought to embed climate resilience and hazard mitigation into their disaster relief responses. Several states, including Alabama, Louisiana, and North Carolina, have created roof fortification programs meant to encourage homeowners to harden their homes against climate disasters, although the effectiveness of these programs has varied widely. Several states, including California and Minnesota, have also enacted rules requiring insurers to offer discounts to homeowners that make climate resilient property upgrades.

Legislation

Regulation

- **Colorado S.B.23 16 (enacted 2023):** Requires, beginning in 2024, each insurance company that reports more than $100 million on its annual schedule T filing to participate in and complete the NAIC's "Insurer Climate Risk Disclosure Survey" or successor survey or reporting mechanism.

- **Connecticut S.B.1202 (enacted 2021):** Requires the Insurance Commissioner to submit a report biennially to the State Legislature on progress toward addressing climate-related risks; incorporating the greenhouse gas reduction targets of the state into the department's regulatory and supervisory actions; and regulatory and supervisory actions to bolster the resilience of insurers to the physical impacts of climate change.

- **New York A.B.9905A (introduced 2024):** Requires insurers to report on their investments related to fossil fuels; prohibits insurers from underwriting new fossil fuel projects; prohibits insurers from refusing to issue or renew policies solely based on the policyholder's location or source of income; requires the Department of Financial Services to conduct a study on methods to keep property and casualty insurance affordable in vulnerable communities.

Disaster Relief/Hazard Mitigation

- **California S.B.30 (enacted 2018):** Requires the California Department of Insurance Commissioner to convene a working group to recommend: market mechanisms that promote investment in natural infrastructure to reduce the risks of climate change related disasters; create incentives for investment in natural infrastructure to reduce risks to communities, and provide mitigation incentives for private investment in natural lands.
    - » See the Working Group's initial report.

- **California S.B.1060 (passed Senate 2024):** Requires property insurers to consider the wildfire risk reduction benefits of hazardous fuel reduction, home hardening, defensible space, and other fire prevention activities by incorporating these mitigation activities into insurance underwriting models.

- **Colorado H.B.21 1208 (enacted 2021):** Creates a fee paid by insurance companies on natural disaster policy premiums, such as those for fire and crop failure; creates a state-run natural disaster mitigation enterprise fund.

- **Connecticut S.B.1115 (introduced 2023):** Enacts a surcharge on Connecticut insurers that underwrite new fossil fuel projects.

Additional Resources

- **4 Principles for Addressing Climate Risks in the Insurance Industry** I ***CAP***
- **Climate Risk and State Insurance Policy** I ***Climate Cabinet***
- **Policy Visions for the Home Insurance Crisis** I ***Climate and Community Project***
- **Demystifying the National Association of Insurance Commissioners** I ***Revolving Door Project***

Section 4
Case Study: Arizona's Success Fighting Anti-ESG Legislation

Overview

The state of Arizona has faced several challenges to ESG investing in recent years. However, despite rapid action in other states with similar political contexts, Arizona was able to stave off most of the anti-ESG momentum at the legislative level. There are several key criteria that contributed to this success: (1) bipartisan opposition and involvement of county treasurers, (2) working with new organizations, and (3) strong messaging.

1. Bipartisan Opposition & Involvement of County Treasurers

In addition to the action in the legislature itself, both the Arizona County Treasurers and the Arizona Association of Counties advocated against these bills. An open letter was written to members of the legislature with 14 of the 15 County Treasurers signing on. The political breakdown of Arizona County Treasurers is 5 Democrats, 1 Independent, 9 Republicans, so this was a truly bipartisan effort.

2. Working with New Organizations

The Arizona County Treasurers Association reached out to organizations that they felt would be opposed to anti-ESG legislation such as the Arizona Bankers Association, to build a stronger coalition in dissent.

3. Strong Messaging

In Arizona, when fighting against anti-ESG efforts, the coalition centralized around two key arguments: that the legislation was anti-free market and resulted in an increase of taxes. Other arguments included the impact to government banking rather than focusing on issuing government debt.

> **Example:** "Jay Kaprosy of the Arizona Bankers Association said in testimony on Arizona's proposed SB 1138, 'What you have in front of you is probably the most anti-free market bill that you'll see this legislative session.' Because of the blatantly anti-free market nature of this legislative trend, business groups, chambers of commerce, and trade associations representing the financial sector led the charge against anti-ESG bills."

Additional Resources

- **Arizona Coconino County Treasurer Anti-ESG Legislation Op-Ed** I ***AZ Central***
- **Arizona Chamber of Commerce Anti-ESG Legislation Op-Ed** I ***AZ Central***

National Caucus of Environmental Legislators

202.744.1006 • www.ncelenviro.org • 1100 H St NW, Suite 600 • Washington, DC 20005

NOTES

Climate Finance Briefing Book

202.744.1006 • www.ncelenviro.org • 1100 H St NW, Suite 600 • Washington, DC 20005