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Red state vs. blue fight heats up as anti-ESG becomes law in Florida

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It's official. No municipal bonds will be able to be issued in the state of Florida under the environmental, social or governance label or by using an ESG bond verifier.

Gov. Ron DeSantis on Tuesday signed the bill passed last week by the Legislature that bans the issuance of municipal bonds using ESG precepts.

Florida Gov. Ron DeSantis at a news conference in Jerusalem last week. The governor was on trade tour that took him to Israel, Japan, Korea and the United Kingdom. **Bloomberg News**

House Bill 3 passed in the Senate on April 20 by a 23 to 12 vote along party lines in the red state. It was approved March 24 by the House by an 80 to 31 vote. The Florida Legislature is dominated by Republicans in both houses who agree with the governor's stance on social issues.

The law also prohibits an issuer from using a rating agency if an ESG score negatively impacts their bond rating.

Ben Watkins, director of the state Division of Bond Finance, said the law establishes policies and guardrails regarding what is acceptable in investment decision-making and debt issuance and excludes social, political and ideological considerations.

"In the debt world, this means muni bonds cannot be labeled or designated as ESG bonds, green bonds or social bonds," Watkins told The Bond Buyer.

"Also, since there is no pricing benefit from labeled bonds, issuers cannot spend public funds on verifiers since there is no tangible benefit from selling ESG-labeled bonds. Issuers should not be spending money on marketing gimmicks in selling their bonds," he said.

"When the rating agencies developed and rolled out their ESG scores, they said their ESG scores would not impact an issuer's credit rating," he said. "We are holding them to their word, so that ESG scores do not in the future creep into directly impacting issuer credit ratings."

The law's intention is not to prevent rating agencies from considering environmental factors in their credit analysis, but rather to prevent any future attempt to map a separate ESG score into the overall creditworthiness of an issuer, supporters of the bill say.

DeSantis said the rating agencies, which he noted are paid by Florida and its local entities when they apply for a rating, have been creating their own ESG scores in addition to their credit analysis.

"Look, if you're going to do something separate and it doesn't go into credit ratings — we don't necessarily like that, but it's not affecting us," DeSantis said a news conference in Jacksonville. "The danger I think is that there's a movement to take the ESG score and put it in as part of your credit determination. So you could be perfectly creditworthy and then they're saying you're not doing the right ideology and then you get dinged when it comes to that — that's unacceptable."

He continued, "what we're saying is if the rating agencies are [tracking] creditworthiness and keeping that with integrity, then great, you're good. If you fuse the ESG score with that, then we are not going to be doing business with you. And I think Texas is going to do the same thing."

DeSantis, a Republican, is seen as one of the top contenders for the GOP presidential nomination in 2024, although he has not yet declared his candidacy. Last week, he made a trade tour, visiting Israel, the United Kingdom, South Korea and Japan.

The law also codifies actions taken by the State Board of Administration at the governor's direction to ensure all investment decisions must be driven solely by pecuniary factors and may not sacrifice investment returns to promote factors like ESG and extend those requirements to state and local funds.

Additionally, the law bans state and local entities from considering or giving preference to ESG as part of the procurement and contracting process.

For businesses, it prohibits banks engaging in what it says is "corporate activism" from holding public deposits as a qualified public depository and bans financial institutions from discriminating against customers for their religious, political, or social beliefs.

It also forbids the financial sector from considering "social credit scores" in banking and lending practices that aim to prevent Floridians from obtaining loans, lines of credit, and bank accounts.

"In Florida and across the nation, we've heard from law-abiding small business owners and consumers who've been denied access to financial services because of where they work or what they believe in," DeSantis said. "Florida will continue to lead the nation against big banks and corporate activists who've colluded to inject woke ideology into the global marketplace, regardless of the financial interests of beneficiaries."

The law empowers the state's attorney general, chief financial officer and commissioner of financial regulation to enforce these provisions.

The law has both potential benefits and consequences, said Emily Magee, a lawyer with Butler Snow's public finance, tax incentives and credit markets group in Jacksonville, Florida.

"While I cannot say for certain the effect the law will have on financial institutions, the law appears to create a 'boycott' element we have seen in other states such as Texas, which enables the state to sanction financial institutions that have adopted ESG policies that preclude them from servicing certain industries," she told The Bond Buyer.

"Such sanctions may force banks that serve as underwriters for municipal bonds out of Florida, which would narrow the pool of underwriters available to Issuers and potentially raise borrowing costs for Florida issuers," she said. "However, the law may also create opportunities for banks unbridled by ESG policies to expand their market share in Florida."

However, critics of the law cited several problems.

"The bill, in my opinion, is completely indefensible if challenged in court," said Ken LaRoe, president and CEO of Climate First Bank in Florida, a two-year old start-up.

"Backed by ESG principles, Climate First Bank is a full-service community bank offering personal and commercial banking services with a focus on environmental sustainability," its website says.

"It's nothing but marketing for DeSantis anyway. It's nothing but marketing for all the Republicans. So they don't care if it'll be challenged — they're not footing the bill for a challenge, the citizens are. It's antithetical to anything democracy, anything patriotism, anything capitalism, anything public service — everything the Republicans say they stand for. It's just silly hogwash."

LaRoe, who is also a lawyer, said if it's challenged in court "there's just no way it could be upheld."

But he said it's going to be a long battle.

"I just can't believe that my state has gotten to this point of utter insanity," he said. "It's a world turned upside down, where doing good is bad."

Other critics of the law say it has been drafted too broadly.

"The law is broadly worded in its prohibition of 'ESG bonds' in the state," Neal Pandozzi, a partner at Bowditch & Dewey, told The Bond Buyer. "From a legal perspective, I remain concerned about potential unintended consequences arising from the breadth of the language."

The law could cause a ripple effect across the country, he added.

"It could also have a precedent-setting effect beyond Florida, given the range of ESG-related policies recently adopted or under consideration in other states," he said. "As a practical matter, I will be interested to see how Florida effectuates the law and to what extent other states take notice."

Lawyers have brought up the possibility of litigation before.

"Once you start to change the fiduciary duty standard at a state level, would that lead to future litigation? Potentially," Leah Malone, partner and head of the ESG and sustainability practice at Simpson Thacher & Bartlett LLP, told the Bond Buyer in March.

"The case law in this area is built up over decades and once a law comes into effect that targets one way that fiduciary duties are being exercised, that's going to create a lot of confusion."

Lance Dial, a partner at Morgan Lewis, said the issue will likely end up in court.

"There's going to be a direct conflict at some point that will eventually lead to an impossible situation for investment managers," Dial said in March.

"It is anti-free market to prohibit full access to information. I think [Florida] and other states would like to limit shareholder rights in order to create a Soviet-style planned economy, where the government tells business what to do" said Illinois State Treasurer Michael Frerichs.

Blue state officials took issue with the latest developments in the Southeast.

Illinois State [Treasurer]Michael Frerichs said the law was clearly heading in the wrong direction.

"I think Gov. DeSantis is more interested in scoring political points than he is in protecting Florida taxpayers," Frerichs, a Democrat, told The Bond Buyer. "He's more interested in running for president than he is in securing a good retirement for his citizens."

In Illinois, he said, as a fiduciary for college savings plans and retirement savings plans, he wanted to see disclosure on all risk factors that affect the long-term sustainability of a business or locality.

"It is anti-free market to prohibit full access to information. I think he and other states would like to limit shareholder rights in order to create a Soviet-style planned economy, where the government tells business what to do" Frerichs said.

Frerichs said real free market conservatives believe in the free market and not governmental control.

"We think for a free market to operate well, there needs to be free disclosure of information. That's what we ask of our investment managers in Illinois," he said.

Monica Reid, founder and chief executive officer of Kestrel, an Oregon-based verifier of green, social and sustainability bonds, said Florida's law will mean less information for investors.

"First and foremost, at Kestrel we believe that the free exchange of information is a fundamental component of the free market," Reid told The Bond Buyer. "We're disappointed in the governor's decisions to limit communities' and issuers' ability to communicate with investors, because that's really what the second party verification is."

Green, social and sustainability bonds saw a 1% growth by par volume and by transactions between 2021 and 2021 even with a roughly 40% year-over-year decline in issuance, according to Kestrel.

"The issuers are already doing this work," Reid said. "The financed activities that have an environmental or social benefit are already happening, and we shed light on the impact of those financed activities and then we provide that information in a standardized way so investors have the information they need."

The law is akin to "throwing the baby out with the bathwater,"
said John Mousseau, president and chief executive officer of Cumberland Advisors.

"If you're the city of Miami, and issuing debt that's going toward remediation of your flooding problems, and classifying that as a green bond, do you want to limit the issuance of the bond, when you're basically issuing funds to help out the most valuable real estate in the whole state?" Mousseau asked. "It's a little silly."

Florida has suffered from several extreme weather events in recent years, which show little sign of abating, and "some of the remediation issues are going to be handled in the municipal bond market," Mousseau said. "Don't you want issuers to have the flexibility to make themselves stronger in a state that's very much affected by climate?"

The impact on Florida bond prices remains to be seen, Mousseau said.

"In the end you always end up doing the best thing for your clients, so if Florida bonds cheapen because of a bias against this type of legislation, you probably end up buying more of them," he said.