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Florida Law to Restrict the Use of Certain ESG Factors by Asset Managers and Financial Institutions

The legislation mirrors anti-“industry boycott” legislation introduced or passed in other US states and provides more explicit rubrics of prohibited factors.

On May 5, 2023, Florida Governor Ron DeSantis signed into law House Bill 3, a comprehensive anti-ESG bill that restricts consideration of environmental, social, and governance (ESG) factors in various contexts (HB 3). The law, scheduled to take effect on July 1, 2023, builds on the State Board of Administration’s [August 2022 resolution](#) providing that its own investment decisions must be based only on pecuniary factors that do not include “the consideration of the furtherance of social, political, or ideological interests.” HB 3 amends a variety of Florida statutes relating to: (i) retirement plans and investments of funds; (ii) financial institutions, including qualified public depositories; (iii) money services businesses; (iv) consumer finance companies; (v) trust fund assets and public funds; (vi) government contracts; (vii) government bonds; and (viii) deceptive and unfair trade practices.

HB 3 fulfills the promises of a 19-state [alliance](#) formed on March 16, 2023, by Governor DeSantis and the governors of Alabama, Alaska, Arkansas, Georgia, Idaho, Iowa, Mississippi, Missouri, Montana, Nebraska, New Hampshire, North Dakota, Oklahoma, South Dakota, Tennessee, Utah, West Virginia, and Wyoming to push back against what they believe to be President Biden’s ESG agenda. Pursuant to the alliance’s [policy statement](#), the governors have agreed to lead their respective state-level efforts to:

- protect taxpayers from ESG influences across state systems, such as by blocking the use of ESG in all investment decisions at the state and local level, so that only “financial factors are considered to maximize the return on investment ... [and] eliminating consideration of ESG factors by state and local governments when issuing bonds or prohibiting state fund managers from considering ESG factors when investing taxpayer money”; and
- protect citizens from ESG influences in the financial sector, including “banning the sector from considering so-called “Social Credit Scores” in banking and lending practices ... [as well as] including stopping financial institutions from discriminating against customers for their religious, political, or social beliefs, such as owning a firearm, securing the border, or increasing [America’s] energy independence.”

This Client Alert summarizes the key requirements imposed by HB 3.

Investment Decisions and Obligations of Investment Advisers/Managers

HB 3 will require that all investment decisions made by investment advisers or managers on behalf of Florida public pensions, public educational institutions, and other state retirement funds be based only on “pecuniary factors.” “Investment manager” is defined by Florida Statute, Section 215.855 as a private-sector company that offers one or more investment products or services to a governmental entity and that has the discretionary investment authority for direct holdings; however, it is not entirely clear how broadly this definition will apply to the various Florida statutes that HB 3 amends. In addition, when deciding whether to exercise shareholder rights or when exercising such rights on behalf of a Florida retirement system or plan, including the voting of proxies, only pecuniary factors may be considered.

Like the August 2022 Florida Board resolution, HB 3 defines “pecuniary factor” as a factor that is “prudently determine[d] to be expected to have a material effect on the risk or returns of an investment based on appropriate investment horizons consistent with applicable investment objectives and funding policy.” And like the August 2022 resolution, HB 3 specifically states that the term “pecuniary factor” “does not include the consideration or furtherance of any social, political, or ideological interests.” However, neither the August 2022 resolution nor HB 3 defines what constitutes a “social, political, or ideological interest.” Interestingly, HB 3 does not include the terms “environmental,” “net zero,” or “climate change” as part of the “social, political, or ideological” carveout to pecuniary factors.

By December 15, 2023, and every two years thereafter, each Florida retirement system or plan must file a comprehensive report detailing and reviewing the governance policies concerning decision-making in vote decisions and adherence to the fiduciary standards required of such retirement system or plan under this section, including the exercise of shareholder rights. It remains to be seen what information these Florida entities will request or require of their investment advisers or managers to be able to fulfill their obligations to file this report.

HB 3 will have consequences for arrangements entered into on or after its effective date, July 1, 2023. Notably, investment advisers and managers who have discretionary investment authority for direct holdings and who are retained by relevant Florida entities on or after July 1, 2023, will be required to contractually agree to certify in writing annually that all investment decisions made on behalf of trust funds and the Florida board are made based solely on pecuniary factors and do not subordinate the interests of the participants and beneficiaries of the funds to other objectives, including sacrificing investment return or taking additional investment risk to promote any “nonpecuniary factor.” This annual written certification is due by January 31 for the reporting period of the previous calendar year. Failure to comply with the certification requirement could give rise to civil or administrative action by the Florida Attorney General for damages, injunctive relief, “and such other relief as may be appropriate.”

Moreover, failure to timely file these certifications may lead to termination of the contracts between the investment manager or adviser and the Florida entity, and materially false certifications will be considered a willful refusal to comply with the manager’s or adviser’s fiduciary duties.

While the pecuniary factors requirement does not necessarily prohibit the consideration of ESG factors, it does emphasize the importance of investment advisers and managers articulating the rationale between the consideration of ESG factors and associated risk/return impacts for their strategies, including their internal governance records. And to the extent their investments include ESG considerations, they may consider a clear link between pecuniary impacts or assumptions and the ESG considerations, highlighting that these are value accretive considerations. If investments include any climate change considerations, it may be helpful to clarify that these climate change considerations are pecuniary and not “political or ideological factors,” to the extent that the clarification is accurate.

HB 3 will also require private investment managers to include the following disclaimer language in any written communications between an investment manager to a company in which the manager invests public funds on behalf of a governmental entity that discuss social, political, or ideological interests, subordinates the interests of the company's shareholders to the interest of another entity, or advocates for the interest of an entity other than the company's shareholders: *"The views and opinions expressed in this communication are those of the sender and do not reflect the views and opinions of the people of the State of Florida."* (emphasis added)

New Standards on "Unsafe and Unsound Practices" for Financial Institutions

HB 3 imposes new restrictions on financial institutions as defined under Chapter 655 of the Florida Statutes,¹ which includes qualified public depositories and money services businesses, regarding the consideration of certain factors in business or investment decisions. Namely, HB 3 requires financial institutions to "make determinations about the provision or denial of services based on an analysis of risk factors unique to each current or prospective customer or member" and prohibits engagement in a list of "unsafe and unsound practices."

The listed unsafe and unsound practices include the denial, cancellation, or other discrimination in the availability or terms of services to any person on the basis of:

- a) the person's political opinion, speech, or affiliation;
- b) the person's religious beliefs, exercise, or affiliation (subject to certain exceptions for religious-based financial institutions);
- c) any factor that is not a quantitative, impartial, and risk-based standard, including any such factor related to the person's business sector; or
- d) the use of any rating, scoring, analysis, tabulation, or action that considers a "social credit score," based on factors including, but not limited to, the person's:
 - i. political opinions, speech, or affiliations;
 - ii. religious beliefs, exercise, or affiliations;
 - iii. lawful ownership of a firearm;
 - iv. engagement in the lawful manufacture, distribution, sale, purchase, or use of firearms or ammunition;
 - v. engagement in the exploration, production, utilization, transportation, sale, or manufacture of fossil fuel-based energy, timber, mining, or agriculture;
 - vi. support of state or federal efforts to combat illegal immigration, drug trafficking, or human trafficking;
 - vii. engagement with, facilitation of, employment by, support of, representation of, advocacy for, or business relationship with any person described in the categories above; or
 - viii. failure to meet or commit to meet, or expected failure to meet (i) environmental, social governance, corporate board, or company employment composition standards, benchmarks, or requirements; or (ii) policies or procedures requiring or encouraging employee participation in social justice programming, including diversity, equity, or inclusion training, in each case, provided that the person is in compliance with applicable state or federal law.

While many of these requirements mirror anti-"industry boycott" legislation introduced or passed in other US states, HB 3 provides more explicit rubrics of prohibited factors in financial institutions' decision-making.

Beginning July 1, 2023, and each year thereafter, financial institutions must attest, under penalty of perjury, to whether they are acting in compliance with these requirements by completing a form

prescribed by the state. Failure to comply with the requirements, or to submit such form, will subject financial institutions to the applicable sanctions and penalties provided for general violations of the code. Importantly, for banks, savings banks, or savings associations that are qualified public depositories, this may also include suspension or disqualification as a QPD, which would restrict their ability to hold public deposits.²

Other Aspects of the New Legislation

HB 3 provides for certain other limitations on the consideration of ESG factors by state and local governments. Namely:

- **Government contracts.** HB 3 prohibits consideration of “social, political, or ideological interests” in government contracting. While the legislation does not expressly prohibit the consideration of ESG-related factors to the extent important to contracting terms, the practical effect when considered with other provisions in the legislation will likely be the elimination of such considerations from requests for proposals or other state and local government contracting processes in Florida for most, if not all, circumstances.
- **ESG bonds and ratings.** HB 3 prohibits state and local entities, including municipalities and educational institutions, from issuing ESG bonds (including green, climate, social, and sustainable bonds), or contracting for the services of a third-party verifier regarding ESG-related bond characteristics (e.g., for a second-party opinion) from July 1, 2023, onward. The legislation also prohibits state and local entities from entering into contracts with “any rating agency whose ESG scores for such issuer will have a direct, negative impact on the issuer’s bond ratings.” This second prohibition is not qualified as being limited to ESG bonds, so it could impact identification of ratings providers for any municipal bonds or similar offerings to the extent ESG factors are included in the rating methodology.

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Endnotes

¹ Chapter 655 of the Florida Statutes defines a financial institution as "a state or federal savings or thrift association, bank, savings bank, trust company, international bank agency, international banking corporation, international branch, international representative office, international administrative office, international trust entity, international trust company representative office, qualified limited service affiliate, credit union, or an agreement corporation operating pursuant to s. 25 of the Federal Reserve Act, 12 U.S.C. ss. 601 et seq. or Edge Act corporation organized pursuant to s. 25(a) of the Federal Reserve Act, 12 U.S.C. ss. 611 et seq." Edge Corporations are corporations engaging in international or foreign banking or other international or foreign financial operations. This definition does not appear to include private funds.

² Given that Chapter 655 of the Florida Statutes applies to state-chartered financial institutions, there is a prevailing view that these provisions would apply solely to state-chartered financial institutions and not to nationally chartered banks.