Prepared Statement

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I thank Chairman McHenry and the other members of this committee for the opportunity to offer my views on this important topic of the ongoing politicization of corporate management decisions. This perverse trend has been strengthened substantially by the deeply problematic proxy advisory process, and by the efforts of federal regulatory agencies to facilitate it and to extend their regulatory activities into matters with respect to which they have little expertise and only the most tenuous statutory authority, if any.

At the most general level, that process has evolved into a system in which proxy advisors with little personal stakes in the outcomes of management decisions can indulge their own political preferences through pressures on corporate managements, while bearing little or none of the ensuing consequences, however adverse in terms of the interests of shareholders due to reduced economic returns. Such a reduction in economic returns means for the economy in the aggregate an inexorable reduction in the efficiency of capital allocation and investment, a reduction in the economic value of the capital stock, a smaller economy in real terms, less employment, and a reduction in labor productivity and wages.

Because of past and ongoing decisions by regulators, the constraints on such behavior and resulting adverse outcomes have weakened. It is not surprising that some regulatory agencies increasingly are playing the age-old game of finding ways to spend other people's money; this is the case in particular for financial regulators seeking to expand their authority to include the requirement and oversight of asserted "climate risk" analysis by institutions subject to their rulemakings. It is crucial that Congress enact legislation reforming the past regulatory actions that have engendered these adverse outcomes, while imposing constraints on the ability of the proxy

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advisers to pursue their political preferences at the expense of shareholders and the economy as a whole, and on the regulatory efforts of financial regulators to promulgate rules in pursuit of goals never envisioned by Congress and not authorized in the respective statutes. This prepared statement is organized as follows.

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Summary

Past and ongoing regulatory efforts by the Securities and Exchange Commission have entrenched a proxy advisory duopoly that has had the effect of increasing the politicization of corporate business decisions and the allocation of capital assets, in particular in pursuit of environmental, social, and governance objectives. This regulatory environment has led to a substantial degree of automatic voting by managements in accordance with the recommendations of the proxy advisers, which have few incentives to pursue the interests of shareholders and the efficient allocation of capital, allowing them to indulge their own personal political preferences.

Under the chairmanship of Mr. Gary Gensler, companies essentially have lost the right to respond to the recommendations made by the proxy advisers, to correct factual errors, and to delineate analytic mistakes and inconsistencies between shareholder interests and the proxy advice. In addition, an important SEC rule (Rule 14a-8) has been changed substantially; previously, it allowed firms to seek a “no action” determination from the SEC staff allowing management to exclude specific shareholder proposals from the annual proxy vote, in particular ones irrelevant to the performance of the firm, certain not to enjoy more than marginal shareholder support, and, crudely, a waste of time and resources. The application of Rule 14a-8 has been changed to require firms to consider resolutions of “wider societal interest.”

One study published in 2020 found that pension funds with an ESG orientation lagged those of non-ESG funds by two basis points per year over a ten-year period. One reason for this systematic underperformance is obvious: An artificial constraint on the securities to be included in a portfolio cannot increase expected returns. Analysis of the effects of ESG investing and business management is complex, but it is unlikely to be small. Such a reduction in economic returns means for the economy in the aggregate an inexorable reduction in the efficiency of capital allocation and investment, a reduction in the economic value of the capital stock, a smaller economy in real terms, less employment, and a reduction in labor productivity and wages.

These effects are difficult to estimate, particularly given that the shift toward business management and investment behavior is constantly evolving, as is the case for policy formulation in this area, so that no long term "equilibrium" impacts yet are observable. But a rough analysis under wholly plausible assumptions suggests that expected investment returns might decline by about 0.4 percent (40 basis points) over a 20-year period. Annual investment might fall by about $16.4 billion, the capital stock over 20 years would decline from $59.4 trillion in 2021 to $52.6 trillion, yielding a decline in annual GDP of $850 billion, other factors held constant, and a decline in the labor share of GDP — wages, salaries, and other compensation — of $510 billion annually, or about 3.3 percent. Even an effect an order of magnitude smaller would not be trivial. However crude these calculations, the adverse effects of a politicization of business management and capital allocation can be serious under assumptions that, again, are wholly plausible, far more so than commonly asserted.

Policymakers would be well advised to focus on regulatory and legal reforms aligning the interests of the proxy advisory firms with those of their clients' shareholders. The large asset managers — Blackrock, State Street, and Vanguard — whatever the justified criticisms aimed at them in this context, nonetheless have shareholders to whom they must answer directly, and thus have far more powerful incentives to make recommendations that are efficient economically. This reality is illustrated by the far weaker support for ESG resolutions by the large asset managers than has been the case for the proxy advisers, or for the smaller institutional asset managers without the resources to do their own independent analyses.

Policymakers should act also to constrain the efforts by regulatory agencies to pursue an expansion of their ability to force ESG and other political objectives through regulatory policies despite the absence of statutory authority to do so. A good example is the SEC proposed rule for "The Enhancement and Standardization of Climate-Related Disclosures for Investors." Among other requirements, it would mandate that public companies estimate their greenhouse gas emissions defined broadly, and analyze the "risks" that their emissions might pose to their current and future investors. The problems that the proposed rule would create are serious, among which would be an increase in the politicized allocation of capital and a reduction in aggregate economic performance. The "information" to be disclosed would not be material, and the responses of public companies would be driven by an imperative to avoid regulatory and litigation threats. No public company has the ability to conduct the analysis demanded by the SEC — even the Intergovernmental Panel on Climate Change has found it effectively impossible in a way consistent with the evidence on climate phenomena — and a massive increase in litigation would be a certainty regardless of how public companies were to respond to the regulatory requirements.

A similar set of problems are attendant upon the "high-level framework" "draft principles" presented by the Board of Governors of the Federal Reserve System for the evaluation and management of climate-related financial risks confronting Fed-supervised financial institutions with over $100 billion in total consolidated assets. The evaluation of such risks would require speculation about the evolution of political conditions and public policies. Moreover, the overwhelming body of evidence suggests strongly that the "transition to a lower-carbon economy" would prove hugely expensive, so that the almost-explicit Fed assumption that such a "transition" is a virtual certainty is not to be taken seriously.

The proponents of policies designed to reduce GHG emissions almost never offer projections of the climate impacts that their proposals will yield. Accordingly, it is important for this committee to note, even in summary fashion, the future climate effects of public policies and private actions reducing GHG emissions. A good example is the net-zero emissions policy of the Biden administration: Applying the Environmental Protection Agency climate model, under assumptions that exaggerate the future effects of reduced emissions of GHG, the net-zero policy implemented immediately would yield a reduction in global temperatures of 0.173°C by 2100. The ESG imperative for emissions commitments would have even smaller effects.

The efforts by ideological, bureaucratic, and economic interest groups to force businesses and asset managers to redirect resources in ways favored politically represent, narrowly, the return of Operation Choke Point, an illegal past attempt to politicize access to capital, one deeply corrosive of our legal and constitutional institutions. More broadly, protection of those institutions is consistent only with formal policymaking by the Congress through enactment of legislation. This institutional protection would preserve the traditional roles of the private sector and of the government, respectively, as part of the larger permanent objectives of maximizing the productivity of resource use under free market competition, and of preserving the political accountability of the policymaking process under the institutions of democratic decisionmaking as constrained by the constitution.

Proponents of the market allocation of resources through the price mechanism — the only system consistent with the preservation of freedom and the avoidance of a long-term shift toward massive central economic planning — clearly recognize and support the right of individuals and groups to use their own resources to pursue their preferred political outcomes. But the politicization of business management decisions and the allocation of capital resources is a serious problem for which government policies are responsible in substantial part. They are, in a word, coercive. It is essential that Congress act to reverse and proscribe the regulatory actions both past and prospective facilitating this growing trend of politicized resource allocation.

The 2003 SEC regulation that has created the ISS/GL proxy advisory duopoly must be reformed. The same is true for the staff actions that have created a requirement that funds must vote on all proxy issues, that funds could avoid liability by retaining proxy advisers, and that the proxy advisers would bear liability only in extreme cases.

The right of companies to respond to the recommendations made by the proxy advisers, to correct factual errors, to point out analytic mistakes and inconsistencies between shareholder interests and the proxy advice, and other such relevant parameters must be reestablished. The recent weakening of the right of firms to seek a "no action" determination under SEC Rule 14a-8 must be strengthened, in particular by removing the "wider societal interest" criterion for disapproval of "no action" requests by firms with respect to proxy proposals irrelevant, politicized, already rejected solidly by shareholders, and/or wasteful.

Congress should act to constrain the ability of regulatory agencies to expand their mandates beyond those authorized by statute, and I hope that the Congressional Review Act will be applied with increasing frequency. Above all, Congress must make it clear that only under new legislation can regulatory efforts to force reductions in GHG emissions be justified.

I. The Proxy Advisory Process and the Increasing Politicization of Corporate Management Decisions

In 2003, the Securities and Exchange Commission promulgated a regulation that has engendered an unintended and adverse outcome: a duopoly of firms enjoying a position as the most powerful arbiters of corporate governance in America.[1] Those firms, Institutional Shareholder Services (ISS) and Glass Lewis (GL), provide recommendations to investors and asset managers on how they should vote their shares in the context of shareholder proposals. The two account for 97 percent of the market for proxy advisory services, and research has shown that they can shift as much as 30 percent of the votes on proxy proposals.[2] In short, despite lacking any statutory authority, they have become important *de facto* regulators of America's public companies.

Because of subsequent staff interventions and interpretations, the 2003 regulation evolved from a simple requirement that investment funds provide transparency involving potential conflicts into a policy interpreted to mean that funds must vote on all proxy issues, that funds could avoid liability by retaining proxy advisers, and that the proxy advisers would bear liability only in extreme cases.

The "extreme cases" limitation on the potential liability of proxy advisers means that in practice they are effectively unconstrained by fiduciary responsibility considerations. Accordingly, the personal political preferences of the proxy advisers or their staffs — often oriented toward specific policy or political goals — carry substantial weight in decisions on proxy matters, including executive compensation and corporate policies on a range of social and environmental questions. The climate "crisis" and the pursuit of "sustainability" are popular ones, and it is no surprise that many of the proxy advisers' staff bureaucrats are enamored with them. Put aside the very large substantial *climate* uncertainties discussed in the scientific literature, including those outlined by the Intergovernmental Panel on Climate Change itself.[3] The resulting impacts on *business* risks extending far into the future would be deeply speculative, and the definition of "sustainability" is vastly more ambiguous than commonly asserted.[4]

Because the managers avoid liability by retaining proxy advisers, it is unsurprising that they have been induced to defer to their recommendation on a large percentage of questions, a dynamic facilitated by automatic (or "robo-") voting. Even in the case of funds that evaluate proxy advisers' recommendations independently, acceptance of those recommendations has evolved into the default option in many cases, while rejection of the recommendations has become more exceptional, a dynamic that research has found consistent with the empirical evidence.[5] Another study found that "175 asset managers with more than $5 trillion in assets under

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[1] See https://www.sec.gov/rules/final/33-8188.htm.

[2] See https://corpgov.law.harvard.edu/2018/06/14/the-big-thumb-on-the-scale-an-overview-of-the-proxy-advisory-industry/.

[3] For innumerable examples, see https://judithcurry.com/. The IPCC 6th Assessment Report, containing voluminous discussions of the various uncertainties is at https://www.ipcc.ch/assessment-report/ar6/.

[4] See https://www.usnews.com/opinion/articles/2016-05-25/future-generations-resources-dont-depend-on-investment-in-sustainability.

[5] See https://media4.manhattan-institute.org/sites/default/files/R-JC-0518-v2.pdf and https://accfcorpgov.org/wp-content/uploads/2018/10/ACCF_ProxyProblemReport_FINAL.pdf.

management have historically voted with ISS on both management and shareholder proposals more than 95 percent of the time."[6]

Automatic voting in effect outsources the evaluation of proxy proposals to the proxy advisers, an outcome that disenfranchises shareholders to a substantial degree, because the interests of the proxy advisers are not aligned with those of the shareholders. This outsourcing inserts between the managers of the businesses, their boards, and those to whom they have a fiduciary responsibility an external decision-maker, specifically, the proxy adviser. Apart from reducing the transparency of decisions on proxy proposals, the proxy advisers have no obvious responsibility or incentives to respond to inquiries from investors, and communications between investors, managers, and proxy advisers are hardly frictionless. The systematic deference manifesting itself in automatic voting yields an incentive for proxy advisers to adopt stances reflecting their personal policy and political preferences, as distinct from parameters driven by fiduciary responsibilities to the shareholders and fund participants.

The adverse effects of the 2003 rule and the ensuing staff interventions and interpretations have been exacerbated sharply with the increase in politicized regulation by the SEC, in particular under the chairmanship of Mr. Gary Gensler. Previously, companies had the right to respond to the recommendations made by the proxy advisers, correcting factual errors, pointing out analytic mistakes, inconsistencies between shareholder interests and the proxy advice, and the like. In addition, an important SEC rule allowed firms to seek a "no action" determination (SEC Rule 14a-8) by the SEC staff allowing management to exclude specific shareholder proposals from the annual proxy vote, in particular ones irrelevant to the performance of the firm, certain not to enjoy more than marginal shareholder support, and, crudely, a waste of time and resources.[7]

Under the chairmanship of Mr. Gensler, companies essentially have lost the right to respond to the recommendations made by the proxy advisers. In addition, Rule 14a-8 has been changed substantially; as now applied, it requires firms to consider resolutions of "wider societal interest," yielding a predictable surge in the number of proposals having far less to do with shareholder value than with the latest fashions in environmental, social, and governance political imperatives, in which both activists and the proxy advisory firms pursue their own political preferences on such topics as climate change, efforts not consistent with the interests of shareholders.[8]

The adverse effects of this shift in SEC priorities away from the disclosure of material information in pursuit of shareholder protection and economic efficiency are illustrated by the recent annual general meeting of CNX Resources, a natural gas producer with substantial

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[6] See https://accf.org/wp-content/uploads/2018/11/ACCF-RoboVoting-Report_11_8_FINAL.pdf.

[7] SEC rule 14a-8 in particular. See https://corpgov.law.harvard.edu/2023/01/12/sec-rule-14a-8-shareholder-proposals-no-action-requests-determinants-and-the-role-of-sec-staff/#:~:text=Since%201947%2C%20no%2Daction%20letters,matters%20related%20to%20shareholder%20proposals.

[8] See https://www.responsible-investor.com/us-firms-lose-appetite-for-no-action-efforts-on-esg-proposals-following-sec-shift/, https://www.npr.org/2023/04/09/1168446621/businesses-face-more-and-more-pressure-from-investors-to-act-on-climate-change, and https://www.budget.senate.gov/imo/media/doc/Dr.%20Benjamin%20Zycher%20-%20Testimony%20-%20Senate%20Budget%20Committee.pdf.

operations in West Virginia.[9] Shareholder Handlery Hotels proposed that CNX disclose its lobbying activities and confirm that they are consistent with the Paris Climate Agreement.[10] CNX explained in great detail that it does not lobby for or against the Paris agreement, a stance of neutrality unlikely to satisfy the politicized demands of such entities as Handlery.[11] Handlery's efforts were implemented by an organization called Proxy Impact, in the view of which it is Environmental, Social, and Governance imperatives — the pursuit of political objectives — that is the appropriate central goal of business management.[12]

Handlery refused to meet or discuss the issue with the CNX management, at which point ISS recommended that shareholders vote in favor of the Handlery resolution.[13] And then ISS too refused to meet with CNX.[14] CNX thus was left with only one option: a supplemental filing with the SEC, a legal action in a regulatory context that consumes nontrivial financial resources and management time and attention, and that carries real legal liability because the supplemental filing is a formal action to the SEC.[15]

The entire exercise was purely wasteful: Shareholders rejected the Handlery resolution by more than 76 percent. Neither Handlery nor Proxy Impact nor ISS had to bear any of the attendant costs themselves; instead, the politicized regulatory regime under Chairman Gensler allows them to promote the latest fashions in ESG objectives with literally no fiduciary duty or interest of their own at stake. It is the SEC, in particular under Chairman Gensler, that has shunted aside the SEC's advertised role as a protector of investors, promoter of fairness in securities markets, and facilitator of informed decisions and confident investments by investors, in favor of a facilitation of politicized securities markets.[16]

II. Adverse Economic Impacts of the Proxy Adviser Process

The effects of the voting recommendations from the proxy advisory services are unlikely to be small: Recent research focusing on ISS finds that a negative recommendation results in a 25 percent reduction in support for the given proxy proposal.[17] Because those voting recommendations are not constrained by a fiduciary responsibility to maximize value for the shareholders, it is not difficult to predict that the increasing ESG orientation of the proxy advisers

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[9] See https://www.cnx.com/.

[10] See https://www.realclearmarkets.com/articles/2020/11/19/the_perversities_of_biden_rejoining_the_paris_climate_agreement_650234.html?mc_cid=de5e2e6646&mc_eid=5a039925c5.

[11] See https://www.cnx.com/cnx/media/Pdf/CNX-Lobbying_Trade-Assoc.pdf and https://www.positiveenergyhub.com/cnx-addresses-shareholder-proposal.

[12] See https://www.proxyimpact.com/about. "Proxy Impact was launched to help foundations and sustainable and impact investors align their investments and values. We provide environmental, social and sustainable governance (ESG) shareholder engagement and proxy voting services that promote sustainable and responsible business practices."

[13] See https://www.positiveenergyhub.com/cnx-invites-handlery-hotels-ceo-to-attend-annual-shareholder-meeting and https://www.positiveenergyhub.com/cnx-responds-regarding-shareholder-proposal.

[14] See https://www.positiveenergyhub.com/cnx-responds-to-institutional-shareholder-services-regarding-report.

[15] See https://www.sec.gov/Archives/edgar/data/1070412/000107041223000062/def144-21x2023.htm.

[16] See https://www.sec.gov/about.

[17] See https://academic.oup.com/rfs/article-abstract/29/12/3394/2418027?redirectedFrom=fulltext.

and the increasing pressures on management to endorse them — driven in substantial part by regulators — have had the effect of undermining business performance.

One study published in 2020 found that pension funds with an ESG orientation lagged those of non-ESG funds by two basis points per year over a ten-year period: "Social investing yields lower returns" and "any form of social investing is not appropriate for public pension funds."[18] A 2019 study finds no "evidence that high-sustainability funds outperform low-sustainability funds. This in reality is evidence of underperformance consistent with the "nonpecuniary motives influencing investment decisions," that is, lower potential costs of obtaining capital as a result of a preference on the part of some investors to use their own capital to further social ends.[19] It also is possible that companies or funds pursuing "fashionable" social ends (or claiming to do so) encounter lower costs of obtaining human capital (labor) inputs. Another study reports similar findings: "The results of empirical studies examining the relationship between ESG investing and asset returns (cost of capital) are inconclusive. Many studies find positive or negative relationships, while many do not find any significant relationship."[20]

One reason for this systematic underperformance is obvious: An artificial constraint on the securities to be included in a portfolio cannot increase expected returns. This is a reality summarized by one analyst as follows: "Screening techniques based on non-pecuniary factors lead to a reduced number of stocks in a portfolio and therefore an increased probability that the big winners in the stock market will be excluded from or underweighted in an investment portfolio. The result will be reduced expected returns versus a comparable benchmark."[21] Divestment from investments in fossil-fuel producers is a central ESG objective, but a recent analysis shows that such divestment imposes substantial trading, diversification, and compliance costs. The diversification cost in particular is striking in its magnitude: the "diversification cost from divesting energy stocks [is] approximately 0.5 percent per year."[22]

Again, it is not surprising that the expansion of political criteria in business and portfolio management would yield a reduction in financial performance over the longer term.[23] Such a reduction in economic returns means for the economy in the aggregate an inexorable reduction in the efficiency of capital allocation and investment, a reduction in the economic value of the capital stock, a smaller economy in real terms, less employment, and a reduction in labor productivity and wages. Such effects are difficult to estimate, particularly given that the shift toward business

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[18] See https://crr.bc.edu/esg-investing-and-public-pensions-an-update/.

[19] See https://onlinelibrary.wiley.com/doi/abs/10.1111/jofi.12841.

[20] See https://www.fraserinstitute.org/sites/default/files/ESG-myths-realities-esg-investing-and-asset-returns_0.pdf.

[21] See https://blogs.law.ox.ac.uk/business-law-blog/blog/2020/10/true-expectations-expected-mediocre-long-term-returns-esg-index-funds.

[22] See https://divestmentfacts.com/pdf/Fischel_Report.pdf.

[23] We might observe an increase in stock and portfolio returns in the short run if firms favored on ESG or "sustainability" grounds also happen to be doing well for other reasons. Perhaps more important, an increase in ESG investing on the part of investors might drive up those stock prices, but then the "overpriced" stocks might therefore yield reduced returns after the increase in demand for those securities was reflected fully in the prices of the securities. See, e.g., https://kenaninstitute.unc.edu/kenan-insight/does-esg-investing-generate-higher-returns/#:~:text=For%20example%2C%20in%20the%20short,driving%20up%20their%20stock%20prices. This is a dynamic issue not of direct interest here, but it is difficult to see how an artificial constraint on investment choices can fail to depress returns.

management and investment behavior is constantly evolving, as is the case for policy formulation in this area, so that no long term "equilibrium" impacts are observable.

But it is possible to derive some (very) rough parameters of interest.[24] The labor share of U.S. GDP is about 60 percent.[25] U.S. gross private investment in 2021 was about $4.1 trillion, with a total private capital stock of about $59.4 trillion on a current-cost estimation basis.[26] Before-tax corporate profits in 2022 were $3.35 trillion, or about 13.2 percent of GDP.[27] If we accept for estimation purposes the finding reported above of a decline in returns of 2 basis points per year (over a ten-year period), that works out to a decline in expected returns of about 0.4 percent (40 basis points) over a 20-year period. If we assume that investment is proportional to expected returns, and that the $4.1 trillion in gross private investment in 2021 was an equilibrium level, then annual investment would fall by about $16.4 billion, to $4.0836 trillion. Assume an annual depreciation rate of 8 percent; the capital stock over 20 years would decline from $59.4 trillion in 2021 to $52.6 trillion in 2041. Accordingly, the capital stock would fall by $340 billion per year on average.[28]

If the capital share of GDP is 40 percent, that implies a decline in annual GDP of $850 billion, other factors held constant, and a decline in the labor share of GDP — wages, salaries, and other compensation — of $510 billion annually, or about 3.3 percent.[29]

Obviously, these calculations are very crude, and ignore changes in the effects of technological advance on the productivity of inputs ("total factor productivity") and a host of other parameters. "Other factors held constant" is no small constraint. But the central qualitative conclusion to be observed is that the adverse effects of a politicization of business management and capital allocation can be serious under assumptions that are wholly plausible, far more so than commonly asserted. Even if the rough calculation above overstates the labor compensation effect by a factor of ten, that still would yield a reduction of a third of a percent. Policymakers must bear this in mind.

III. An Incentives Contrast Between the Proxy Advisers and the Large Asset Managers

I urge this committee to focus on legislative reforms oriented toward the proxy advisers and the regulatory agencies. The large ("Big Three") asset managers — Blackrock, State Street, and Vanguard — have received sharp criticism for their past and continuing efforts to force ESG

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[24] I emphasize here that these estimates are gross at best, and I do not recommend that they be used for any purpose other than the crude observations presented here.
[25] See https://fred.stlouisfed.org/series/LABSHPUSA156NRUG.
[26] See, respectively, https://apps.bea.gov/iTable/?ReqID=10#eyJhcHBpZCI6MTAsInN0ZXBzIjpbMSwyLDNdLCJkYXRhIjpbWyJDYXRlZ29yaWVzIiwiUHVibGljRkFBIl0sWyJUYWJsZV9MaXN0IiwiNjEiXV19 and https://apps.bea.gov/iTable/?ReqID=10#eyJhcHBpZCI6MTAsInN0ZXBzIjpbMSwyLDNdLCJkYXRhIjpbWyJDYXRlZ29yaWVzIiwiUHVibGljRkFBIl0sWyJUYWJsZV9MaXN0IiwiMTgiXV19. The Bureau of Economic Analysis of depreciation rates is at https://apps.bea.gov/national/pdf/BEA_depreciation_rates.pdf.
[27] See https://fred.stlouisfed.org/series/A053RC1Q027SBEA#0 and https://fred.stlouisfed.org/series/GDP#0.
[28] Author computations, available upon request.
[29] GDP in 2022 was $25,462.7 billion. The labor share of 60 percent would be $15,277.6 billion. See the GDP data at https://fred.stlouisfed.org/series/GDP#0.

considerations into management decisions.[30] But because the asset managers must answer to shareholders interested in returns to their investments higher rather than lower, the asset managers continue to be constrained by incentives not applicable in the case of the proxy advisory firms, which, as noted above, can impose pressures for ESG and other political imperatives while bearing few of the attendant costs, if any.

This fundamental difference in incentives is reflected in the sharp disparity in voting behavior on ESG proposals between the three large asset managers and ISS and GL. One recent report found that the Big Three asset managers voted against ESG resolutions more frequently than was the case for ISS and GL.[31] These five institutions voted in favor of such resolutions as follows. ISS: 75 percent of the resolutions; GL: 41 percent; State Street: 29 percent; Blackrock: 24 percent; and Vanguard: 9 percent.

It is likely to be the case that the large asset managers by virtue of the resources at their disposal, are able to evaluate proposals and make their own determinations about the voting decisions that will serve the interests of their shareholders. This is likely to be less true for the smaller institutional shareholders, which tended to a much greater degree to engage in automatic voting driven by the proxy advisors' recommendations. A recent study of this phenomenon found that "Overall, 114 institutional investors voted in lockstep alignment with either ISS or Glass Lewis in 2020: 86% of robovoting investors used ISS and 14% used Glass Lewis, reflecting the dominant market position of ISS."[32]

It may be the case that the regulatory conditions leading firms to accept the recommendations of the proxy advisers may also impose obstacles to the entry of new advisers specializing in providing recommendations to the smaller institutional investors. This is a question that this committee usefully might consider.

IV. Regulatory Efforts to Force Implementation of Climate Policies By the Private Sector

Climate policy obviously is a topic of central prominence, and a potential source of increased budgets for government agencies, even apart from the ideological component of bureau behavior. In the context of this hearing this has been the case in particular for the SEC and for the Board of Governors of the Federal Reserve System.

Consider the SEC proposed rule for "The Enhancement and Standardization of Climate-Related Disclosures for Investors."[33] Among other requirements, it would mandate that public companies estimate their greenhouse gas emissions defined broadly, and analyze the "risks" that

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[30] See, e.g., https://www.pionline.com/esg/anti-esg-pushback-forcing-asset-managers-awkward-political-corner, https://www.cadwalader.com/cwt-climate/index.php?eid=237&nid=55, and https://www.forbes.com/sites/christinero/2023/01/29/whats-behind-the-esg-investment-backlash/?sh=1502b02c3158.

[31] See https://shareaction.org/reports/voting-matters-2022.

[32] See https://corpgov.law.harvard.edu/2021/05/27/proxy-advisors-and-market-power-a-review-of-institutional-investor-robovoting/.

[33] The proposed rule has been published in the Federal Register at https://www.govinfo.gov/content/pkg/FR-2022-04-11/pdf/2022-06342.pdf.

their emissions might pose to their current and future investors. The problems that the proposed rule would create are serious. Firm-specific greenhouse gas emissions, even if defined broadly, are not material information for investors because such firm-specific emissions would yield climate impacts effectively equal to zero. Accordingly, firm-specific emissions cannot affect the prospective returns to investment in that firm. Only under an assumption of government policies penalizing GHG emissions can such information be material, and such policies for the most part have not proven politically viable.

The estimation of climate "risks" by public companies would be futile, politicized, distorted by an imperative to avoid regulatory and litigation threats, and largely arbitrary. Global GHG emissions can be material, but the model-driven estimation of global risks has proven difficult in the extreme, subject to profound disagreement in the peer-reviewed literature.[34] That reality is demonstrated by the fact that the mainstream climate models have overestimated the actual temperature record by a factor of over two.

The obvious effect of the proposed rule would be creation of powerful incentives for public companies to undertake climate analysis driven not by the actual evidence and the peer-reviewed literature on climate phenomena. Instead, they will be driven to undertake such analysis, whether in response to regulatory directives or to political pressures, under assumptions and methodologies insulating them from adverse regulatory actions and litigation threats. This incentive structure would yield politicized analysis biased heavily toward published estimation of climate "risks" greater rather than smaller on the part of public companies, with no economic or other relevant benefits for investors. This would provide regulators and other public officials a rationale for constraining capital access for disfavored firms and sectors, resulting in a misallocation of capital and a reduction in aggregate economic performance, with no measurable climate benefits. The proposed rule cannot satisfy any plausible benefit/cost test, and should be discarded.

The SEC recognizes the litigation threat explicitly but fails to note that the litigation problem is created by virtually any "risk" analysis. Should, say, a severe storm follow a company's conclusion that climate risks are unimportant in its specific context, the plaintiff attorneys will not be far behind, even though attribution of a given weather event to GHG emissions generally, and *a fortiori* to emissions attributable to a given firm, is deeply problematic. Should a firm calculate its GHG emissions as high relative to other companies or sectors, it will expose itself to litigation as a "cause" of the asserted costs of the anthropogenic climate change "crisis." This proposed rule guarantees adverse litigation for public companies under almost any set of assumptions, a cost not estimated or noted by the SEC.

No public company and few, if any, government administrative agencies are in a position to evaluate climate phenomena, whether ongoing or prospective, with respect to which the scientific uncertainties are vastly greater than commonly asserted. The range of alternative assumptions about central parameters is too great to yield clear implications for the climate "risks" facing specific public companies, economic sectors, and geographic regions. Those central parameters include the choices among climate models, the assumed sensitivity of the climate system to increases in the atmospheric concentration of greenhouse gases (GHG), ensuing conclusions about the relative contributions of natural and anthropogenic influences upon climate

[34] See the voluminous discussions at https://judithcurry.com/.

phenomena, the assumed future increase in atmospheric GHG concentrations through, say, 2100, and the analytic assumptions underlying calculations of the effects of aerosol emissions on cloud formation, about which surprisingly little is known. That short list is far from exhaustive.

The SEC attempts to circumvent this obvious reality by asserting that "… that the science of climate modelling has progressed in recent years and enabled the development of various software tools and … climate consulting firms are available to assist registrants in making this determination." Apart from the SEC recognition that the proposed rule will create (or expand) an industry of consultants, the assertion that "the science of climate modelling has progressed in recent years and enabled the development of various software tools" is deeply disingenuous. The mainstream climate models have a poor track record in terms of predicting the actual temperature trend of recent decades, having consistently overstated that trend by a factor of over two.

Application of the Environmental Protection Agency climate model suggests strongly that climate policies, whether implemented by the U.S. government alone or as an international cooperative policy, would have temperature effects by 2100 that would be virtually undetectable or very small. Such policies cannot satisfy any plausible benefit/cost test. This point is discussed further in section V below.

That observation is strengthened by the analysis presented in the proposed rule. The SEC estimate of the attendant change in external costs per fiscal year is an increase from $3.86 billion to $10.24 billion, an increase of 165 percent. "Internal" burden hours are projected to rise from 18.8 million hours to 43.5 million hours, or about 131 percent. These costs are almost certainly biased downward, in that the proposed rule would create powerful incentives to retain consultants and other outside experts to conduct the requisite measurements, again as the proposed rule recognizes explicitly.

If public companies are driven to use the same (or similar) sets of assumptions about central parameters, a very real danger would arise of more-or-less homogeneous predictions inconsistent with historical, ongoing, and prospective climate phenomena. If public companies opt to use sets of assumptions that differ in important dimensions, the ensuing predictions about future climate phenomena ("risks") would vary substantially, yielding very large uncertainties in terms of the information made available to investors. But — again — firm-specific greenhouse gas emissions, even if defined broadly, are not material information for investors because such firm-specific emissions would yield climate impacts effectively equal to zero.

It is reasonable to hypothesize also that the aggregate benefits (that is, positive "risks") of increasing GHG concentrations, as reported by the National Oceanic and Atmospheric Administration and in the peer-reviewed literature, will be excluded from such analytic efforts. It is reasonable to hypothesize further that such analyses will exclude the risks of climate policies, prominent among which are the large and adverse implications of artificial increases in energy costs. Such policy risks are likely to be greater when implemented by bureaucracies insulated from democratic accountability.

Anthropogenic climate change is "real" in that increasing atmospheric concentrations of GHG have yielded effects that are detectable. But they are much smaller than commonly asserted;

and there is no evidence in support of the ubiquitous assertions of a climate "crisis," whether ongoing or looming, and no evidence in support of the even more extreme "existential threat" argument. Moreover, the available analysis suggests that the financial risks of anthropogenic climate change in the aggregate are much smaller than many assert: Both the central integrated assessment model and the IPCC in its most alarmist analyses calculate that anthropogenic climate change unmitigated by policy initiatives would reduce global per capita incomes by less than 1.5 percent by the end of this century, a figure almost certainly not statistically significant, and in any event at a time when the world is certain to be vastly wealthier than is the case currently.

Because the perceived "climate "risks" confronting public companies are dependent upon crucial choices among alternative assumptions, the evaluation of such "risks" would be largely arbitrary given that the "correct" assumptions are very far from obvious. This means that a requirement, whether formal or informal, that climate "risks" be reported to investors would weaken the materiality standard for disclosures by those institutions, even apart from the larger non-materiality reality noted above.

"Materiality" always has meant the disclosure of information directly relevant to the ongoing or prospective financial performance of the given public company. When "risk" analysis becomes an arbitrary function of choices among assumptions complex, opaque, and far from obvious, the traditional materiality standard inexorably will be diluted and rendered far less useful for the investment and capital markets, an outcome diametrically at odds with the ostensible objectives of those advocating the evaluation of climate "risks." Moreover, the "risks" of anthropogenic climate change are far from the only such mass-geography "risks."[35] A bias toward focusing only on climate "risks" would distort the allocation of capital.

The combination of very great climate uncertainties and the litigation threat will create a demand from the business sector for detailed regulations on how to structure the analysis of climate risks. Because the uncertainties attendant upon the future effects of increasing atmospheric concentrations of GHG are so great, a top-down regulatory approach for the evaluation of any attendant "risks" is itself very risky. A wiser approach would entail allowing market forces to make such "risk" determinations in a bottom-up fashion, thus avoiding an obvious politicization of the allocation of capital.[36]

A similar set of problems are attendant upon the "high-level framework" "draft principles" presented by the Board of Governors of the Federal Reserve System for the evaluation and management of climate-related financial risks confronting Fed-supervised financial institutions with over $100 billion in total consolidated assets.[37] The Fed assumes physical risks that are not consistent with the body of evidence on climate phenomena, and a prospective evolution of climate-related public policies that at most are highly unlikely to be implemented and in reality would prove virtually impossible to implement. Moreover, financial institutions, however large,

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[35] Consider the variety of potential low-probability catastrophes: mass contagion, huge volcanic eruptions, large earthquakes and tsunamis, large asteroid strikes, bioterrorism, nuclear war, and on and on.
[36] For a full critique of the SEC proposed rule, see https://www.sec.gov/comments/s7-10-22/s71022-20132286-302818.pdf.
[37] See https://www.govinfo.gov/content/pkg/FR-2022-12-08/pdf/2022-26648.pdf.

are incapable of conducting the requisite analysis of future climate phenomena — even the Federal government cannot do so in a way that is consistent with the data — with respect to which the scientific uncertainties are vastly greater than commonly asserted. With respect to the transition (policy-related) risks noted by the Fed in its draft principles: The evaluation of such risks would require speculation about the evolution of political conditions and public policies. Moreover, the overwhelming body of evidence suggests strongly that the "transition to a lower-carbon economy" would prove hugely expensive, so that the almost-explicit Fed assumption that such a "transition" is a virtual certainty is not to be taken seriously.

The range of alternative assumptions about central parameters is too great to yield clear implications for the climate "risks" facing specific financial institutions, economic sectors, and geographic regions. Those central parameters include the choices among climate models, the assumed sensitivity of the climate system to increases in the atmospheric concentration of greenhouse gases (GHG), ensuing conclusions about the relative contributions of natural and anthropogenic influences upon climate phenomena, the assumed future increase in atmospheric GHG concentrations through, say, 2100, and the analytic assumptions underlying calculations of the effects of aerosol emissions on cloud formation, about which surprisingly little is known. That short list is far from exhaustive.

If large financial institutions banks are driven to use the same (or similar) sets of assumptions about central parameters, a very real danger would arise of more-or-less homogeneous predictions inconsistent with historical, ongoing, and prospective climate phenomena. If they opt to use sets of assumptions that differ in important dimensions, the ensuing predictions about future climate phenomena ("risks") would vary substantially, yielding very large uncertainties in terms of the information made available to investors and regulators.

The proposed requirement for the analysis of "transition risks" assumes a "transition" away from fossil fuels that is very likely to border on the impossible as a matter of economic feasibility. In any event, any such analysis of "transition risk" must be based upon predictions of the future evolution of energy and other policies over decades, an exercise in political prognostication that no financial institution, however large — indeed that anyone — is in a position to undertake in a fashion that is not wholly speculative.

V. Can Regulatory Enforcement of Private-Sector Climate Actions Affect Climate Phenomena?

It is curious that the proponents of policies designed to reduce GHG emissions almost never offer projections of the climate impacts that their proposals will yield. So divorced from these realities are the numerous policy initiatives, that the proponents now usually define the benefits not in terms of, say, reductions in future temperatures, but instead in terms of reductions in the emissions of GHG multiplied by an estimate of the "social cost of carbon," a wholly artificial construct that literally is independent of the actual evidence on climate phenomena and the impact of increasing atmospheric concentrations of GHG.[38]

[38] For a fuller discussion of this problem see https://www.aei.org/wp-content/uploads/2023/07/EPA-multi-pollutant-RIN-2060-AV49-MY2027-later-Zycher-comment-July-5-2023.pdf.

Accordingly, it is important for this committee to note, even in summary fashion, the future climate effects of public policies and private actions reducing GHG emissions. Obviously, any such climate effects are prospective, and so a model must be used to project them. Let us apply the Environmental Protection Agency climate model to various reductions in GHG emissions, both domestic and international, under an assumed equilibrium climate sensitivity of 4.5°C.[39]

Net-zero U.S. GHG emissions effective immediately would yield a reduction in global temperatures of 0.173°C by 2100. That effect would be barely detectable given the standard deviation (about 0.11°C) of the surface temperature record.[40] The entire Paris agreement: about 0.178°C. A 50 percent reduction in Chinese GHG emissions: 0.184°C. Net-zero emissions by the entire Organization for Economic Cooperation and Development: 0.352°C. A global 50 percent reduction in GHG emissions implemented immediately and maintained strictly would reduce global temperatures in 2100 by 0.687°C. Note that GHG emissions in 2020 fell by about 3.7 percent as a result of the COVID-19 economic downturn.[41] Can anyone believe that even larger GHG reductions — and the attendant economic costs — are plausible politically?

The ESG imperative for emissions commitments would have even smaller effects, although it is difficult to find quantitative estimates from the proponents. This, again, is a reality that this committee should consider.

VI. The Corrosion of Constitutional Institutions and Principles

The efforts by ideological, bureaucratic, and economic interest groups to force businesses and asset managers to redirect resources in ways favored politically would distort the allocation of capital away from economic sectors disfavored by certain political interest groups pursuing ideological agendas. This would represent the return of Operation Choke Point, an illegal past attempt to politicize access to capital, one deeply corrosive of our legal and constitutional institutions.[42]

Protection of those institutions is consistent only with formal policymaking by the Congress through enactment of legislation, rather than with powerful pressures, whether formal or informal, exerted by the SEC, the Fed, or other regulatory agencies. This institutional protection would preserve the traditional roles of the private sector and of the government, respectively, as part of the larger permanent objectives of maximizing the productivity of resource use under free

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[39] Author computations. See the EPA climate model at https://magicc.org/. An assumed ECS of 4.5°C is the high point of the "likely" ECS range reported by the IPCC in the AR5, and higher than the high point of 4°C in the "likely" range in the IPCC AR6. See the AR5 at https://www.ipcc.ch/site/assets/uploads/2018/02/WG1AR5_TS_FINAL.pdf, at p. 81, and the AR6 at https://www.ipcc.ch/report/ar6/wg1/downloads/report/IPCC_AR6_WGI_TS.pdf, at p. 46.

[40] See https://agupubs.onlinelibrary.wiley.com/doi/pdf/10.1029/1999JD900835.

[41] See https://www.nature.com/articles/d41586-021-00090-3.

[42] See, e.g., https://www.realclearmarkets.com/articles/2021/02/17/with_politicized_lending_biden_aims_to_revive_operation_choke_point_660612.html, https://thehill.com/blogs/congress-blog/politics/415478-operation-choke-point-reveals-true-injustices-of-obamas-justice/ and https://thehill.com/blogs/congress-blog/politics/415478-operation-choke-point-reveals-true-injustices-of-obamas-justice/.

market competition, and of preserving the political accountability of the policymaking process under the institutions of democratic decisionmaking as constrained by the constitution.

Congress has enacted no statute requiring direct reductions in GHG emissions and no statute defining changes in climate phenomena as a threat to the business sector or to the economy. The various subsidy programs and other such policies may or may not be based upon assumptions about the effects of those policies on future GHG emissions, but virtually no such actual constraints have been enacted. Under the constitutional institutions governing U.S. statutory law and attendant policymaking, national "commitments" must be enacted by the Congress; executive orders do not carry the force of law, and as a formal matter it is not clear that they are binding even on executive-branch agencies.[43] The 2009 regulatory finding[44] by the EPA that "six greenhouse gases taken in combination endanger both the public health and the public welfare of current and future generations" is not derived from any law; it is instead a Supreme Court decision that led to it.[45] Because the endangerment finding is regulatory rather than statutory, it can be reversed by a new rulemaking.

VII. Conclusions: Actions Now Appropriate for Congress

Proponents of the market allocation of resources through the price mechanism — the only system consistent with the preservation of freedom and the avoidance of a long-term shift toward massive economic central planning — clearly recognize and support the preferences of some individuals and groups to use their own resources to pursue their preferred political outcomes. But the politicization of business management decisions and the allocation of capital resources is a serious problem for which government policies are responsible in substantial part. They are, in a word, coercive. It is essential that Congress act to reverse and proscribe the regulatory actions both past and prospective facilitating this growing trend of resource use chosen on the basis of political criteria.

The 2003 SEC regulation that has created the ISS/GL proxy advisory duopoly must be reformed. The same is true for the staff actions that have created a requirement that funds must vote on all proxy issues, that funds could avoid liability by retaining proxy advisers, and that the proxy advisers would bear liability only in extreme cases.

The right of companies to respond to the recommendations made by the proxy advisers, to correct factual errors, to point out analytic mistakes and inconsistencies between shareholder interests and the proxy advice, and other such relevant parameters must be reestablished. The recent weakening of the right of firms to seek a "no action" determination under SEC Rule 14a-8 must be strengthened, in particular by removing the "wider societal interest" criterion for disapproval of "no action" requests by firms with respect to proxy proposals irrelevant, politicized, already rejected solidly by shareholders, and/or wasteful.

Congress should act to constrain the ability of regulatory agencies to expand their mandates

[43] See https://crsreports.congress.gov/product/pdf/R/R46738.
[44] See https://www.federalregister.gov/documents/2009/12/15/E9-29537/endangerment-and-cause-or-contribute-findings-for-greenhouse-gases-under-section-202a-of-the-clean.
[45] See *Massachusetts* v. *EPA,* 549 U.S. 497, 525 (2007).

beyond those authorized by statute, and I hope that the Congressional Review Act will be implemented with increasing frequency. Above all, Congress must make it clear that only under new legislation can regulatory efforts to force reductions in GHG emissions be justified.