MEMORANDUM

To: Members of the Committee on Financial Services

From: Committee Staff

Date: July 11, 2023

Subject: July 14, 2023, Housing and Insurance Subcommittee Hearing entitled, "How Mandates Like ESG Distort Markets and Drive Up Costs for Insurance and Housing"

On Friday, July 14 at 9:00 a.m., the Subcommittee on Housing and Insurance will hold a hearing entitled, "How Mandates Like ESG Distort Markets and Drive Up Costs for Insurance and Housing." Testifying at the hearing will be:

- **Mr. Jerry Theodorou**, Director of the Finance, Insurance and Trade Policy Program, R Street Institute
- **Ms. Alicia Huey**, Chairman, National Association of Home Builders (NAHB), and President of AGH Homes, Inc.
- **Mr. Bill Boor**, President & CEO, Cavco Industries, on behalf of the Manufactured Housing Institute
- **Ms. Caroline Nagy**, Senior Policy Counsel for Housing, Corporate Power, and Climate Justice, Americans for Financial Reform

The hearing will highlight how government-imposed mandates like environmental, social, and governance (ESG) increase the cost and limit the availability of insurance and housing in America. Such mandates and other regulations at the federal, state, and local levels distort markets and increase the unaffordability of products for consumers. The Committee will explore these impacts and highlight solutions that lower costs and expand consumer choices.

Summary

Without question, the imposition of government regulations and mandates at the federal, state, and local level adds cost to our economy. These requirements, of course, come with trade-offs. Those that noticeably improve areas like health and safety at minimal cost are generally seen as worthwhile, while others that offer no discernable benefit or add disproportionate costs can negatively affect consumers. Striking the correct balance is essential to preventing market distortions and maximizing consumer choice and product availability.

Both the insurance and housing markets are particularly influenced by a wide array of government regulations and mandates that add to the costs faced by consumers. For insurance, which is largely regulated at the state level, consumer prices are affected by government mandates on the factors that

go into the modeling of risk and setting of rates across a population, requirements on how and where coverage must be made available, and other social objectives such as state-level environmental policies. For housing, such policies include exclusionary and restrictive zoning requirements, questionable environmental mandates, adherence to social goals that distort risk-based pricing, and misguided economic policies that have increased the cost of construction and the shortage of labor. While these requirements are borne of genuine concerns about limited availability or affordability, they often have the paradoxical effect of producing higher costs and fewer choices in the housing and insurance sectors.

What is ESG?

One type of mandate that is affecting housing and insurance providers is ESG, which stands for "Environmental, Social, and Governance." According to the Corporate Finance Institute (CFI): "ESG is a framework that helps stakeholders understand how an organization is managing risks and opportunities related to environmental, social, and governance criteria."[1] Broadly speaking, ESG refers to the environmental, social, and corporate governance factors that are taken into consideration when a business is making fundamental decisions. The use of an ESG framework for decision-making, which has become more popular over the past few years, has widespread implications for consumers especially regarding where and when capital is invested in a market.

Increasingly, some aspects of government have seized upon the ESG movement to expand their regulatory authority beyond its traditional limits. Regulators are using ESG to force businesses into different capital allocation choices at the expense of their fiduciary duties to shareholders, customers, and employees. As the CFI has stated: "ESG has changed how capital allocation decisions are made by many of the largest financial services firms and asset managers in the world."[2] These efforts have the potential to influence all sectors of the economy based on the social preferences of regulators and not their prudential authorities. As a result, ESG mandates can have a significant impact on the cost and availability of products like housing and insurance for consumers across the country without discernable benefits.

ESG's Impact on the Insurance Industry

As mentioned above, insurance is primarily a state-regulated product. Since enactment of the McCarran-Ferguson Act in 1945, insurance companies have been subject to comprehensive state regulation for both the products they sell and the financial solvency of their operations. In both instances, insurers are subject to intense scrutiny regarding their pricing, risk modeling, and use of historical and analytical information. Insurance is, and should be, a data-driven product that reflects the real-world risks and costs of providing access to financial protection against a peril in a marketplace.

[1] Kyle Peterdy, "ESG (Environmental, Social, & Governance): A management and analysis framework to understand and measure how sustainably an organization is operating," June 30, 2022, available at: https://corporatefinanceinstitute.com/resources/esg/esg-environmental-social-governance/.

[2] *Ibid.*

While our state-based insurance model has long been successful, it is not immune from the recent encroachment of the ESG movement. In addition to its prudential rules, in some places, regulators are attempting to add new requirements that are increasingly incompatible with how insurance companies operate to in a solvent manner. For example, some jurisdictions are restricting the use of actual loss data or predictive modeling in setting premiums for certain types of perils. In others, activists want regulators to dissuade or restrict the sale of coverage to legal but unpopular industries. Still others seek to capitalize on the reputational risks of insurers by having them divulge the extent of their global investments in projects based on fossil fuels. Instead of making insurance more consumer-accessible, such ESG mandates will only further distort insurance markets and lead to higher premiums and decreased product availability.

ESG's Impact on the Housing Industry

The influence of new ESG mandates at the federal, state, and local levels could have consequential impacts for consumers and how capital is allocated in our housing markets. Combined, these multiple layers of existing requirements contribute heavily to the cost of housing in a variety of ways. At the state and local levels, this includes the impact of exclusionary and restrictive zoning requirements, prohibitions on energy sources like natural gas, and misguided economic policies that add to both the cost of construction and shortage of qualified labor. At the federal level, factors include attempted application of expansive environmental policies, imposition of new Department of Housing and Urban Development (HUD) noise regulations that prohibit building near transit, and the application of Davis-Bacon prevailing wage rules.

Compounding these costs with new ESG mandates would further increase housing unaffordability. In fact, according to a recent study from the National Association of Homebuilders, regulations imposed by all levels of government account for $93,870, or 23.8 percent of the current average sales price ($397,300) of a new single-family home.[3] This is true during a time when American families are already stretching to afford shelter. According to recent research, "Between 2019 and 2021, the number of cost-burdened renters—defined as those spending more than 30 percent of their income on housing—increased by 1.2 million to a record 21.6 million households."[4] While many of these existing requirements may have been well-intentioned, their cumulative impact has already taken a devastating toll on consumers as the U.S. faces acute shortages of affordable housing in every region of the country. During this time of increased mortgage interest rates and higher inflation, layering new ESG social mandates atop existing ones would have the opposite effect of lowering costs and expanding consumer choices.

[3] NAHB "Regulatory Costs Add a Whopping $93,870 to New Home Prices" May 6, 2021, available at: https://www.nahb.org/blog/2021/05/regulatory-costs-add-a-whopping-93870-to-new-home-prices/#:~:text=Regulations%20imposed%20by%20all%20levels,a%20new%20study%20by%20NAHB.

[4] Joint Center for Housing Studies of Harvard University, "The State of the Nation's Housing 2023," available at: https://www.jchs.harvard.edu/sites/default/files/reports/files/Harvard_JCHS_The_State_of_the_Nations_Housing_2023.pdf.