

MEMORANDUM

To: Members of the Committee on Financial Services

From: Financial Services Majority Staff

Date: September 5, 2024

Re: September 10, 2024, Subcommittee on Oversight & Investigations Hearing Entitled “The Fall of ESG: Scrutinizing the Failed Use of Environmental, Social, & Governance Standards and the Influence of Proxy Advisors.”

On September 10, 2024, at 2:00 p.m. in Room 2128 of the Rayburn House Office Building, the Subcommittee on Oversight and Investigations (Subcommittee) of the Committee on Financial Services will hold a hearing entitled “The Fall of ESG: Scrutinizing the Failed Use of Environmental, Social, & Governance Standards and the Influence of Proxy Advisors.” Testifying at the hearing will be:

- **Charles Crain**, Vice President of Domestic Policy, National Association of Manufacturers
- **Tim Doyle**, Founder and Principal, Doyle Strategies
- **Michael Frerichs**, Treasurer, State of Illinois

This hearing will examine the trends of Environmental, Social, and Governance (ESG) initiatives and the influence of proxy advisory firms on America’s capital markets. The Subcommittee will review why companies and investment firms are turning away from ESG activism and the activist influence of proxy advisory firms.

Background:

Environmental, Social, and Governance (ESG) initiatives of companies throughout the country appear to have reached their peak and are falling out of favor with investors.¹ In 2023, sustainable funds, which prioritize ESG factors when evaluating investments,² realized substantial outflows. In total, these funds saw outflows of \$13 billion due to substandard performance,³ Outflows in the first quarter of 2024 alone reached \$8.7 billion.⁴ Investors have

¹ See James Freeman, *Has ESG Peaked?*, THE WALL STREET JOURNAL, Mar. 15, 2023, <https://www.wsj.com/articles/has-esg-peaked-a45b290c>; Larcker, David F. and Seru, Amit and Tayan, Brian, *Is ESG a Luxury Good?*, (May 3, 2024). Rock Center for Corporate Governance at Stanford University Working Paper Forthcoming, Available at SSRN: <https://ssrn.com/abstract=4816562>;

² *What Are Sustainable Funds and How Have They Performed?*, MORNINGSTAR, Feb. 13, 2024, (“[Sustainable funds] may pursue a sustainability-related theme or explicitly aim to create measurable social impact.”), <https://www.morningstar.com/business/insights/blog/funds/us-sustainable-funds-performance>.

³ Alyssa Stankiewicz, *U.S. Sustainable Funds Register First Annual Outflows in 2023*, MORNINGSTAR, Jan. 17, 2024, <https://www.morningstar.com/sustainable-investing/us-sustainable-funds-register-first-annual-outflows-2023>

⁴ Mahi Roy, *Amid Outflows, Fidelity and Vanguard a Bright Sport for US Sustainable Funds in Q1*, MORNINGSTAR, April 24, 2024, <https://www.morningstar.com/sustainable-investing/us-sustainable-fund-flows-slide-first-quarter-2024>.

pushed to prioritize shareholder value and financial returns, as firms continue to step away from progressive organizations like Climate Action 100+.

Additionally, the proxy advisory industry is now seeing a decline in voting support for ESG initiatives.⁵ Over the past decade, proxy advisory firms have prioritized social and political objectives, with their clients automatically casting votes based on the proxy firms' recommendations. This has led to proxy firms' having an outsized influence, which is evidenced by ESG and anti-ESG shareholder proposals increasing by 5.2 percent above the number of proposals from 2023.⁶ The Subcommittee will review the outsized influence of proxy advisory firms.

⁵ *supra* note 1.

⁶ Noemi Distefano, *Record-Breaking Shareholder Proposals in 2024 Focus on ESG and Anti-ESG matters*, GOVERNANCE INTELLIGENCE, Jul. 5, 2024, <https://www.governance-intelligence.com/shareholders-activism/record-breaking-shareholder-proposals-2024-focus-esg-and-anti-esg-matters#:~:text=Investors'%20ESG%20and%20anti%20ESG,90%20percent%20increase%20on%202022.>