STOP ESG IN BANKING

Do States Have the Legal Authority?

By Justin Haskins

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Introduction

Environmental, social, and governance (ESG) metrics are a popular kind of social credit scoring, one that poses a significant threat to individual liberty and free-market economies, both in the United States and abroad.[1]

ESG is regularly used by corporations and investors as a tool to impose progressive values and environmental policies on other businesses, governments, families, and individuals. ESG has been widely adopted in recent years by corporations across the United States and Europe. A 2023 report by the International Federation of Accountants and the Association of International Certified Professional Accountants found that 95 percent of large global companies produce ESG reports each year.[2]

Since January 2022, freedom-minded policymakers in more than 20 states have introduced legislation designed to discourage or limit the use of ESG by investment management firms, governments, public pensions, and/or financial institutions.[3] These legislative efforts have sought to address the ESG problem in a multitude of ways. For example, lawmakers in Texas and West Virginia have created regulations that prevent state pension funds and some agencies from utilizing services provided by firms that use ESG metrics in some of their most important business practices.

Perhaps the most far-reaching attempt to stop the spread of ESG, however, has come from lawmakers who have proposed regulations that would stop banks and/or insurance companies from using ESG when making determinations about access to banking or insurance services. Dozens of the world's most powerful banks and insurance companies have, to varying degrees, weaponized ESG to screen out businesses and even some individuals who refuse to comply with those institutions' social justice or environmental policies.[4]

Main Bullet Points

- Banks and other financial institutions regularly use ESG to impose their values and environmental views on the rest of society.
- The U.S. Supreme Court has acknowledged that in many situations, states do have the authority to regulate federally chartered banks, including the largest banks in America.
- Existing federal law makes it clear that state lawmakers have the right to regulate federally chartered banks.

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1 For detailed information about ESG, see Jack McPherrin, "Environmental, Social, and Governance (ESG) Scores: A Threat to Individual Liberty, Free Markets, and the U.S. Economy," *Policy Study*, The Heartland Institute, April 2023, https://heartland.org/wp-content/uploads/2023/04/2023-ESG-ReportvWeb-1-4.27.23.pdf

2 Soyoung Ho, "Nearly All Large Global Companies Disclose ESG Information," Thompson Reuters, thompsonreuters.com, March 1, 2023, https://tax.thomsonreuters.com/news/nearly-all-large-global-companies-disclose-esg-information

3 See Jack McPherrin, "Environmental, Social, and Governance (ESG) Scores: A Threat to Individual Liberty, Free Markets, and the U.S. Economy."

4 For some examples, see Justin Haskins, "Are Financial Institutions Using ESG Social Credit Scores to Coerce Individuals, Small Businesses?" *Policy Brief*, The Heartland Institute, February 27, 2022, https://heartland.org/publications/financial-institutions-are-expanding-esg-social-credit-scores-to-target-individuals-small-businesses

Although there are many examples of financial institutions flexing their muscles as a tactic to create larger social changes, perhaps the most economically important is that virtually every large bank in the United States has committed to forcing the businesses they work with to phase out their use of fossil fuels—even if it causes economic harm to customers and business. Many of these financial institutions have pledged to make their entire business portfolios "net-zero emissions" by 2050, and to halve their emissions by 2030, less than seven years from the publication of this paper.[5,6] If fulfilled, these pledges would necessitate that banks eliminate *all* or *nearly all* lending and banking activities with customers who use fossil fuels, including individuals who drive gasoline-powered motor vehicles, significantly impacting virtually every family and industry in the United States.

On May 2, 2023, Florida Gov. Ron DeSantis signed into law historic legislation that restricts banks' use of ESG metrics, the first time such a ban has been established at the state level.[7] Prior to and following the passage of the bill, many bank and insurance lobbyists, left-wing activist organizations, and some Democratic politicians have claimed that states, including Florida, have no right to prevent banks from imposing ESG standards on their customers, even in cases where virtually every bank in a region is using similar metrics. They have claimed state policymakers do not have authority to regulate many of the largest banks operating within their state's borders, because *federally chartered* banks can only be regulated by *federal* agencies.

The best evidence shows that existing federal law *does* grant states the power to regulate banks' use of ESG and other forms of social credit scoring, contrary to the claims of bank lobbyists and their allies.

This paper shows that such claims are false and largely based on a poor understanding of Supreme Court precedence and federal law. The best evidence shows that existing federal law *does* grant states the power to regulate banks' use of ESG and other forms of social credit scoring, contrary to the claims of bank lobbyists and their allies. Thus, legislative efforts such as those achieved in Florida in May 2023 are likely to survive any legal challenges that assert only federal agencies can regulate federally chartered banks on the issue of ESG.

Before providing evidence to support this view, it is important to note that this paper does not seek to persuade lawmakers to pass anti-ESG legislation, including laws governing ESG in banking. It is *solely* focused on the question of the legality of state ESG banking rules.

2 America's 'Dual Banking System'

Unlike many other countries, the United States utilizes a "dual banking system" in which banks are either chartered by a state or federal authority. In a 2018 Congressional Research Service report, attorney Jay Sykes explained that that dual banking system allows banks to "choose to apply for a charter from a state banking authority or a federal charter from the Office of the Comptroller of the Currency (OCC), a bureau within the Department of the Treasury."[8]

5 Justin Haskins, "Are Financial Institutions Using ESG Social Credit Scores to Coerce Individuals, Small Businesses?"

6 Eamon Barrett, "Wells Fargo is the last of the Big Six banks to issue a net-zero climate pledge. Now comes the hard part," *Fortune*, March 9, 2021, https://fortune.com/2021/03/09/wells-fargo-climate-carbon-neutral-net-zero

7 Saul Elbein, "DeSantis signs bill targeting 'discriminatory ESG' in Florida," *The Hill*, thehill.com, May 2, 2023, https://thehill.com/homenews/state-watch/3984507-desantis-signs-bill-targeting-discriminatory-esg-in-florida

8 Jay Sykes, "Banking Law: An Overview of Federal Preemption in the Dual Banking System," *CRS Report*, Congressional Research Service, January 23, 2018, https://sgp.fas.org/crs/misc/R45081.pdf

Sykes further noted, “A bank’s choice of chartering authority is also a choice of primary regulator, as state regulatory agencies serve as the primary regulators of state-chartered banks, and the OCC serves as the primary regulator of national banks.”[9]

This does not mean, however, that state-chartered banks can only be regulated by state authorities or that federally chartered banks must only adhere to federal regulators. Sykes explains,

> Despite receiving their authorities from state law, state banks are subject to many federal laws. Among other federal laws, state banks are subject to certain federal tax, consumer protection, and antidiscrimination laws. Similarly, although they receive their powers from federal law, national banks are not wholly immune from state law. Rather, national banks are often subject to generally applicable state laws concerning contracts, torts, property rights, and debt collection when those laws do not conflict with or frustrate the purpose of federal law.
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> Nonetheless, federal law preempts state laws that interfere with the powers of national banks.[10]

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Federal Preemption

Court opinions, existing federal regulations, and national laws all assert that federal law preempts (supersedes) state banking laws when those laws interfere with the powers given by federal lawmakers to nationally chartered banks. As Sykes notes, this view was solidified by a 1996 Supreme Court case titled *Barnett Bank of Marion County, N.A. v. Nelson*.[11]

In *Barnett Bank*, the Court summarized previous legal decisions and determined, “In defining the pre-emptive scope of statutes and regulations granting a power to national banks, these cases take the view that normally Congress would not want States to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted. To say this is not to deprive States of the power to regulate national banks, where (unlike here) doing so does not prevent or significantly interfere with the national bank’s exercise of its powers.”[12]

This definition clearly fits with state anti-ESG laws like the one passed in Florida in May 2023.

In 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act, commonly called “Dodd-Frank.” It codified the “significantly interfere” preemption standard and applied it to consumer financial protection. In 12 U.S. Code § 25b, under the heading “State law preemption standards for national banks and subsidiaries clarified,” Dodd-Frank defines “state consumer financial law” as “a State law that does not directly or indirectly discriminate against national banks and that directly and specifically regulates the manner, content, or terms and conditions of any financial transaction (as may be authorized for national banks to engage in), or any account related thereto, with respect to a consumer.” This definition clearly fits with state anti-ESG laws like the one passed in Florida in May 2023.

For those who oppose efforts by state lawmakers to limit the use of ESG, the mere mention of the “significantly interfere” standard is enough to end the conversation. Anti-ESG rules “significantly interfere” with the ability of federally chartered banks to engage in standard banking services,

9 Jay Sykes, “Banking Law: An Overview of Federal Preemption in the Dual Banking System.”

10 Jay Sykes, “Banking Law: An Overview of Federal Preemption in the Dual Banking System.”

11 Jay Sykes, “Banking Law: An Overview of Federal Preemption in the Dual Banking System.”

12 *Barnett Bank of Marion County, N.A. v. Nelson* (1996).

they claim, so states must not have the authority to regulate the use of ESG. Further, they often contend that their argument is bolstered because they erroneously say federal law does not empower banks with any right to regulate consumer protection, fair lending practices, and other areas of law relevant to the ESG issue.

These, however, are extremely weak arguments, and in some instances, factually incorrect. First, in many of the cases where federal preemption in banking has been addressed by courts, it has involved attempts by states to *stop* financial institutions from performing a service or offering a product that the financial institution's charter or a federal law clearly intends for the business to engage in, or at least to have the option to engage in.

For example, in *Barnett Bank*, a Florida state law prevented banks from selling insurance in small towns, while a federal law expressly allowed national banks to sell insurance. When there's a conflict between valid federal and state laws, federal law triumphs. In discussing the *Barnett* decision, Sykes wrote, "The Court held that a federal statute granting national banks the authority to sell insurance in such towns impliedly preempted the state law because the state law presented an 'obstacle' to the accomplishment of the federal statute's purpose 'to grant small town national banks the authority to sell insurance, whether or not a State grants . . . similar approval.'"[13]

Anti-ESG laws, however, do not interfere with banks' ability to lend or engage in other kinds of banking services, nor do they act as "obstacles" to banks' powers. In fact, they ensure banks do business with a *greater number* of potential customers than ESG screening would allow for. With anti-ESG banking laws in place, financial institutions will do more business, not less, and with a greater variety of customers. More bank accounts will be open or kept open. More loans and profits will be made. It is hard to imagine, then, that such legislation could be considered prohibitive to banks' rights under their federal charters, especially because their federal charters nowhere state that imposing ESG metrics is a privilege provided to banks. Federal law also does not grant this right to nationally chartered banks.

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Second, the Court in *Barnett* did not stop at the "significantly interfere" standard. It also determined that states can regulate federally charted banks when there are in place "federal banking statutes that accompany a grant of an explicit power with an explicit statement that the exercise of that power is subject to state law."[14]

"Not surprisingly," the Supreme Court added, "this Court has interpreted those explicit provisions to mean what they say."[15]

Put in simpler terms, the Supreme Court has declared that when a federal law gives states the authority to regulate federally chartered banks, states may do so in the applicable areas. As will be shown in the following section, federal law *does* give states the authority to regulate banking activities like those involving ESG, putting state anti-ESG legislation in compliance with the legal standards established by the U.S. Supreme Court in *Barnett*.

13 Jay Sykes, "Banking Law: An Overview of Federal Preemption in the Dual Banking System."

14 *Barnett Bank of Marion County, N.A. v. Nelson* (1996).

15 *Barnett Bank of Marion County, N.A. v. Nelson* (1996).

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Riegle-Neal

In 1994, Congress passed the Riegle-Neal Interstate Banking and Branching Efficiency Act. One of the primary purposes of the law was to make it easier for federally chartered banks to open branches in numerous states.

Under Riegle-Neal, when a federally chartered bank opens a branch, "The laws of the host State regarding community reinvestment, consumer protection, fair lending, and establishment of intrastate branches shall apply to any branch in the host State of an out-of-State national bank to the same extent as such State laws apply to a branch of a bank chartered by that State."[16]

The only exceptions are "when Federal law preempts the application of such State laws to a national bank" or "when the Comptroller of the Currency determines that the application of such State laws would have a discriminatory effect on the branch in comparison with the effect the application of such State laws would have with respect to branches of a bank chartered by the host State."[17]

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Florida's anti-ESG law, and many other similar proposals across the United States, appear to comply with these standards. Anti-ESG bills aim to ensure lending standards are "fair" for all consumers by mandating banks base their lending decisions on financial considerations, rather than ideological concerns, and they help to guarantee consumers are "protected" from unfair, discriminatory practices.

As previously noted, the Dodd-Frank Wall Street Reform and Consumer Protection Act, commonly called "Dodd-Frank," codified the "significantly interfere" standard introduced by *Barnett Bank*. Riegle-Neal, which was passed into law more than a decade before Dodd-Frank, also codifies states' authority to protect bank consumers and ensure fair lending practices. If the drafters of Dodd-Frank had intended to block states from enforcing the consumer protection and fair lending standards of Riegle-Neal, they could have eliminated some or all of the aforementioned sections of Riegle-Neal when they passed Dodd-Frank. They chose not to. That means Congress intended for states to regulate nationally chartered bank practices related to consumer protection and fair lending.

Some will likely argue that the "significantly interfere" standard imposed by Dodd-Frank also applies to Riegle-Neal, and thus to the right for states to regulate fair lending and consumer protection. Even if this is true, however, it poses no difficulties for state officials seeking to stop financial institutions from using ESG and other, similar standards. As noted previously, anti-ESG rules like those passed in Florida do not serve as an "obstacle" to banks seeking to offer savings or checking accounts, loans, or other financial products. They merely ensure that financial institutions do not discriminate against customers on the basis of non-financial criteria. In that respect, they are like other, widely accepted anti-discrimination laws, such as those that stop discrimination on the basis of race or religion.

16 See 12 U.S. Code § 36, https://www.law.cornell.edu/uscode/text/12/36

17 See 12 U.S. Code § 36, https://www.law.cornell.edu/uscode/text/12/36

Some critics have suggested that anti-ESG rules do "significantly interfere" with banks' powers. But if they are correct, then which consumer protection and fair lending practices *can* be regulated by state authorities? Which regulations governing fair lending and consumer protection do not "significantly interfere" with bank activities and policies? Critics appear to have no answer, and for good reason. Many anti-ESG provisions seem to fit so naturally into the definitions of consumer protection and fair lending that virtually any attempt to argue that some forms of consumer protection and fair lending are allowed would force critics to accept that at least some anti-ESG regulations are valid. It is much safer for critics to pretend as though key sections of Riegle-Neal do not exist.

5 Dodd-Frank

Other federal provisions also appear to provide states with the authority to regulate ESG. In Section 1041 of Dodd-Frank, for instance, Congress determined that "a statute, regulation, order, or interpretation in effect in any State is not inconsistent with the provisions of this title if the protection that such statute, regulation, order, or interpretation affords to consumers is greater than the protection provided under this title." Or, put more simply, Dodd-Frank gives state lawmakers the authority to impose *stricter* consumer financial protections than federal law allows. Because state anti-ESG laws are clearly a kind of "consumer financial law" under 12 U.S. Code § 25b, and because they impose "greater" protection for consumers, it seems that state anti-ESG banking laws are permissible under Dodd-Frank.[18]

Congressional Research Service attorney Jay Sykes notes that legal commentators have suggested Section 1041 is a "savings clause" that has been "interpreted as exempting state consumer protection laws from preemption by federal consumer protection laws."[19] Sykes also notes that as of 2018, "no court has interpreted the scope of Section 1041's savings clause."[20]

A 2011 scholarly article authored by Arthur Wilmarth Jr., who was at the time a law professor at George Washington University, supports this view. In the article, titled "The Dodd–Frank Act's Expansion of State Authority to Protect Consumers of Financial Services," Wilmarth noted,

> Notwithstanding the broad powers granted to the [Consumer Financial Protection Bureau], Title X [in Dodd-Frank] does not give the federal government exclusive control over consumer financial protection. Instead, Title X authorizes the states to provide supplemental safeguards to consumers through both lawmaking (as described in this Part) and law enforcement (as discussed in the next Part). Section 1041(a)(1) provides that the CFP Act does not preempt state law "except to the extent that a state law is inconsistent with the provisions of [the CFP Act] and then only to the extent of the inconsistency." Section 1041(a)(2) explains that a state law is "not inconsistent" with the CFP Act—and therefore is not preempted—if the state law provides "greater" protection to consumers than the protection provided by the CFP Act.
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> By giving the states a supplemental lawmaking role with regard to consumer financial protection, Dodd–Frank encourages CFPB and the states to work together with the goal of providing optimal protection to consumers.[21]

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18 As I noted earlier, in 12 U.S. Code § 25b, under the heading "State law preemption standards for national banks and subsidiaries clarified," Dodd-Frank defines "state consumer financial law" as "a State law that does not directly or indirectly discriminate against national banks and that directly and specifically regulates the manner, content, or terms and conditions of any financial transaction (as may be authorized for national banks to engage in), or any account related thereto, with respect to a consumer." Anti-ESG banking regulations clearly fall under this definition.

19 Jay Sykes, "Banking Law: An Overview of Federal Preemption in the Dual Banking System."

20 Jay Sykes, "Banking Law: An Overview of Federal Preemption in the Dual Banking System."

21 Arthur Wilmarth Jr., "The Dodd-Frank Act's Expansion of State Authority to Protect Consumers of Financial Services," GWU Law School *Public Law Research Paper* No. 572; GWU *Legal Studies Research Paper* No. 572, 2011, https://www.law.gwu.edu/sites/g/files/zaxdzs5421/files/downloads/Dodd-FrankConsumer%20Protection.pdf

Later in his article, Wilmarth added,

> As explained above, the CFP Act preempts state laws only when they provide less protection than the CFP Act and the CFPB's regulations. Consequently, the CFP Act establishes a "floor" and not a "ceiling" for consumer financial protection. The limited scope of preemption under the CFP Act is consistent with the "floor" preemption established by most federal laws that protect consumers of financial products, including the Equal Credit Opportunity Act (ECOA), the Electronic Funds Transfer Act (EFTA), the Fair Debt Collection Practices Act (FDCPA), and the Truth in Lending Act (TILA). In this regard, the Senate committee report on Dodd–Frank explained that "Federal consumer financial laws have historically established only minimum standards [of consumer protection] and have not precluded the States from enacting more protective standards. [The CFP Act] maintains that status quo."[22]

In passing Dodd-Frank, it appears that Democratic members of Congress wanted to leave the door open for Democrat-dominated states to issue additional financial regulations that likely couldn't have been passed in Congress at the time Dodd-Frank was signed into law. Ironically, it appears as though the same law could now be used by states to stop banks from imposing left-wing ESG goals through the financial system.

6 Conclusion

State policymakers considering proposals to rein in banks that use ESG and other social credit scoring metrics to screen out, punish, or reward consumers should not be scared off by claims that they have no legal authority to issue ESG banking regulations. The Supreme Court and Congress have granted substantial regulatory powers to states, including in areas that are directly related to ESG.

Of course, having the power to regulate does not mean states must or should do so. Lawmakers should carefully consider the costs and benefits associated with any regulations they choose to impose, including those governing ESG practices, prior to issuing new rules.

22 Arthur Wilmarth Jr., "The Dodd-Frank Act's Expansion of State Authority to Protect Consumers of Financial Services."