KANSAS BANKERS ASSOCIATION

Date: March 8, 2023

To: House Committee on Financial Institutions and Pensions
Representative Nick Hoheisel, Chairman

From: Alex Orel, Senior Vice President – Government Relations
Kansas Bankers Association

Re: **Neutral Testimony on HB 2436**

Mr. Chairman and committee members, I am Alex Orel appearing on behalf of the Kansas Bankers Association (KBA). I am also pleased to introduce Kelly VanZwoll, who serves as Assistant Vice President – Government Relations & Staff Attorney. We look forward to being a resource for you and the committee as you consider financial service issues in the coming weeks and months. Thank you for the opportunity to present testimony today on Environmental, Social, and Governance (ESG) legislation.

Kansas Bankers Association Background Information:

The KBA was founded in 1887, is a voluntary, non-profit trade association governed by its membership. The KBA is headquartered in Topeka, Kansas, and is led by our 24-member board of directors. The KBA staff, which President/CEO Doug Wareham leads, includes 37 professionals, including 11 attorneys, that provide services to Kansas bankers ranging from legislative advocacy to educational training to insurance services to legal and regulatory compliance support. Our mission statement is direct and straightforward:

"Together, we support our member banks and bankers with leadership, advocacy, and education to benefit the communities and customers they serve."

KBA's membership includes 98% of the headquartered banks in Kansas. Our membership also includes 20 out-of-state commercial banks operating in Kansas and seven savings and loans. Our member banks employ more than 22,000 Kansans that provide financial services in every county across the state. While our member banks range in assets from the smallest in our state to the largest in our state, each member bank that belongs to the KBA has one vote on policy positions adopted by either our general membership or our Board of Directors. One member, one vote.

Environmental, Social, and Governance (ESG)

The KBA has been at the forefront of conversations regarding potential legislation ***intended*** to protect our economy's core sectors and prevent discrimination of specific industries, specifically oil and gas and gun manufacturers. Many of the intentions of some policy proposals we have seen in Kansas and nationwide are meant to be helpful, and we appreciate those efforts.

Our basic fundamental principle on ESG is below.

Banks should be free to lend to, invest in, and generally do business with any entity or activity that is legal without government interference. Banks should also be free not to lend, invest or otherwise engage so long as they do not violate fair lending or other anti-discrimination laws.

We are here to present neutral testimony on HB 2436 that could be solution that doesn't create more burdensome regulation, creates unnecessary liability for Kansas banks or businesses, or government intervention into the free market like other proposals we have seen.

We also hope this committee and others in the legislature recognize the national side of this issue. Attached to my testimony are a few articles that highlight some of the federal government and regulatory overreach. You will also see what is currently being done to combat those actions from coalitions in our industry and within the halls of Congress.

On behalf of the banking industry, we would like to express our thanks to the proponents of ESG legislation for working with us and helping address many of our concerns and for the work they put into HB 2436. We are genuinely neutral on HB 2436 and believe the legislation avoids some of the unintended consequences of previous proposals, but that can still make a difference at the state level.

The rest of my remarks will focus on attachments included in my testimony that I presented on during the informational hearing that takes a deeper dive into the issue and give you more of a global look into ESG.

Once again, thank you for the opportunity to provide testimony from our organization, and I would be happy to stand for questions. If you have questions or require additional information later, don't hesitate to contact me at aorel@ksbankers.com or (785) 232-3444.

Environmental, Social, and Governance (ESG) 1-Pager

KBA's Position on ESG

Banks should be free to lend to, invest in, and generally do business with any entity or activity that is legal without government interference. Banks should also be free not to lend, invest or otherwise engage so long as they do not violate fair lending or other antidiscrimination laws.

What is ESG?

ESG stands for environmental, social, and governance. But what does that really mean? ESG is an umbrella term that is intended to push an environmental and social agenda onto the free market, either through government regulation or by market influence over investments through a group of large hedge funds or activists. It can cover a broad spectrum of ethics, sustainability, and risk management issues and can be designed to impact everything from climate change to gun manufacturing or abortion.

How are Banks caught in the middle?

The Biden Administration has had a strong focus on energy independence and the mitigation of climate change. This shift of the political pendulum on energy policy has led federal regulatory agencies (including the Treasury Department, Federal Reserve, FDIC, OCC, and the SEC) to pursue the implementation of ESG policies and guidance for large banks, despite the lack of Congressional direction.

In response, state governments are introducing anti-ESG legislation opposing the use of ESG by investors and businesses, including financial institutions. These proposals attempt to forbid state government from doing business with financial institutions that offer ESG focused investments, forbid state government from entering into state contracts with financial institutions that "boycott" certain businesses due to their ESG policies and prohibit institutions from using ESG factors to "discriminate" against businesses.

Ultimately, this legislation may force businesses and financial institutions to choose between compliance with state laws or their federal regulators.

KBA is working hard to remind policymakers from both sides of the ESG debate that the free market approach to the distribution of capital has provided this country with the strongest and most resilient financial system and economy in the world. Attempts from all sides of the political spectrum to intervene in the redistribution of capital risks undermining that system.

What can State Lawmakers do to help?

- Work with the banking industry on a state level solution that doesn't interject the government in the free market, establish government registries of so called "bad actors", implement punitive penalties, or create unnecessary liabilities for Kansas banks striving to serve their communities.
- Be cognizant of the unintended consequences of proposals that could be inappropriately applied and end up harming an industry caught in the crosshairs of the law.
    - Eg: A banker turns down an application from a borrower for oil and gas production due to a lack expertise on staff or that the requested loan was larger than the bank's lending limit. In return the bank is sued for discrimination for not serving that customer. With ESG legislation in place, the bank could be prohibited from doing business with the state without a true finding of actual discrimination in conflict with the "innocent until proven guilty" basis of law.

For more information please contact Alex Orel at aorel@ksbankers.com or Kelly VanZwoll at kvanzwoll@ksbankers.com or by calling 785-232-3444.

The
KANSAS BANKER

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Pub. 11 2022 Issue 4

- ISSUE HOMEPAGE

President's Message: Will The ESG Pendulum Become A Wrecking Ball?

- Published August 11, 2022

This story appears in
The Kansas Banker Magazine Pub. 11 2022 Issue 4

The KANSAS BANKER

PURCHASE AD SPACE

Banks should also be free not to lend, invest or otherwise engage so long as they do not violate fair lending or other antidiscrimination laws.

In less than two years, the priority of the White House has shifted dramatically from the Trump Administration striving
for energy independence through domestic production to the Biden Administration striving to mitigate climate change by issuing executive orders designed to aggressively transition our nation away from fossil fuels. The shift of the political pendulum on energy policy has led federal regulatory agencies that directly govern or impact the banking industry to draft guidance documents, propose reporting requirements and initiate disclosure standards that are clearly intended to
limit and/or shift capital flowing to energy producers and energy users that produce greenhouse gas emissions. Like it or not, our industry has been pulled into the climate change debate.

The reality is climate change mitigation is only one of many objectives of a broader Environmental, Social and Governance (ESG) movement that is now being embraced by federal regulatory agencies, including the Treasury Department, Federal Reserve, FDIC, OCC, CFTC, and the SEC. ESG implementation by these federal agencies is being aggressively pursued despite the lack of direction from Congress, which begs an important question: ***If Republicans succeed in retaking control of the U.S. Senate and/or U.S. House of Representatives, what will they do in response to the ESG movement?***

The answer to that question will likely come next January, but it's safe to assume a Republican-led House and/ or Senate will push back hard on the ESG movement, which will likely create an unfortunate wrecking ball scenario with the banking industry caught in the middle. In Kansas, we are already keenly aware that some policymakers opposed to the ESG agenda are willing to retaliate against banks that withdraw access to credit in the name of adhering to the objectives of ESG. Legislation was introduced in several state legislatures this past spring, including Kansas, which would have essentially mandated lending and imposed penalties on any bank that restricts or limits capital to "any" legal business and industry. For our industry, these proposals to mandate lending are as damaging and misguided as the progressive ESG requirements they are designed to counter.

KBA recently joined a formal statement sent to the aforementioned federal agencies encouraging them to refrain from enforcing ESG guidance and requirements that would negatively impact the banking industry's ability to provide critical financial services to the customers and communities they serve. The basic fundamental principle outlined in the letter stated:

Banks should be free to lend to, invest in, and generally do business with any entity or activity that is legal, without government interference. Banks should also be free not to lend, invest or otherwise engage so long as they do not violate fair lending or other anti-discrimination laws.

It's unfortunate a letter was required to remind policymakers from both sides of the ESG debate that the ***free market
approach*** to the distribution of capital has provided us with the strongest and most resilient financial system and economy in the world. Hopefully, the ESG pendulum will stop swinging from the left to the right before it becomes a wrecking ball that damages the reputation of our industry and our ability to serve the diverse financial needs of the individuals, businesses, and communities that depend on us.

Please view the ESG State Alliance Letter to Federal Regulators in the ABA & State Bankers Letter article.

https://the-kansas-banker.thenewslinkgroup.org/aba-and-state-bankers-letter/

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Press Release

SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors

FOR IMMEDIATE RELEASE
2022-46

Washington D.C., March 21, 2022 — The Securities and Exchange Commission today proposed rule changes that would require registrants to include certain climate-related disclosures in their registration statements and periodic reports, including information about climate-related risks that are reasonably likely to have a material impact on their business, results of operations, or financial condition, and certain climate-related financial statement metrics in a note to their audited financial statements. The required information about climate-related risks also would include disclosure of a registrant's greenhouse gas emissions, which have become a commonly used metric to assess a registrant's exposure to such risks.

"I am pleased to support today's proposal because, if adopted, it would provide investors with consistent, comparable, and decision-useful information for making their investment decisions, and it would provide consistent and clear reporting obligations for issuers," said SEC Chair Gary Gensler. "Our core bargain from the 1930s is that investors get to decide which risks to take, as long as public companies provide full and fair disclosure and are truthful in those disclosures. Today, investors representing literally tens of trillions of dollars support climate-related disclosures because they recognize that climate risks can pose significant financial risks to companies, and investors need reliable information about climate risks to make informed investment decisions. Today's proposal would help issuers more efficiently and effectively disclose these risks and meet investor demand, as many issuers already seek to do. Companies and investors alike would benefit from the clear rules of the road proposed in this release. I believe the SEC has a role to play when there's this level of demand for consistent and comparable information that may affect financial performance. Today's proposal thus is driven by the needs of investors and issuers."

The proposed rule changes would require a registrant to disclose information about (1) the registrant's governance of climate-related risks and relevant risk management processes; (2) how any climate-related risks identified by the registrant have had or are likely to have a material impact on its business and consolidated financial statements, which may manifest over the short-, medium-, or long-term; (3) how any identified climate-related risks have affected or are likely to affect the registrant's strategy, business model, and outlook; and (4) the impact of climate-related events (severe weather events and other natural conditions) and transition activities on the line items of a registrant's consolidated financial statements, as well as on the financial estimates and assumptions used in the financial statements.

For registrants that already conduct scenario analysis, have developed transition plans, or publicly set climate-related targets or goals, the proposed amendments would require certain disclosures to enable

investors to understand those aspects of the registrants' climate risk management.

The proposed rules also would require a registrant to disclose information about its direct greenhouse gas (GHG) emissions (Scope 1) and indirect emissions from purchased electricity or other forms of energy (Scope 2). In addition, a registrant would be required to disclose GHG emissions from upstream and downstream activities in its value chain (Scope 3), if material or if the registrant has set a GHG emissions target or goal that includes Scope 3 emissions. These proposals for GHG emissions disclosures would provide investors with decision-useful information to assess a registrant's exposure to, and management of, climate-related risks, and in particular transition risks. The proposed rules would provide a safe harbor for liability from Scope 3 emissions disclosure and an exemption from the Scope 3 emissions disclosure requirement for smaller reporting companies. The proposed disclosures are similar to those that many companies already provide based on broadly accepted disclosure frameworks, such as the Task Force on Climate-Related Financial Disclosures and the Greenhouse Gas Protocol.

Under the proposed rule changes, accelerated filers and large accelerated filers would be required to include an attestation report from an independent attestation service provider covering Scopes 1 and 2 emissions disclosures, with a phase-in over time, to promote the reliability of GHG emissions disclosures for investors.

The proposed rules would include a phase-in period for all registrants, with the compliance date dependent on the registrant's filer status, and an additional phase-in period for Scope 3 emissions disclosure.

The proposing release will be published on SEC.gov and in the Federal Register. The comment period will remain open for 30 days after publication in the Federal Register, or 60 days after the date of issuance and publication on sec.gov, whichever period is longer.

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Related Materials

- Proposed Rule
- Fact Sheet
- Comments Received

Wall Street's Biggest Banks Set for Fed Climate Impact Exercise

- Fed's pilot plans to gauge industry readiness for climate risk
- Bank of America, Goldman Sachs among six participants

By
Lydia Beyoud
January 17, 2023 at 2:00 PM CST

Updated onJanuary 17, 2023 at 2:52 PM CST

Wall Street banks including Goldman Sachs Group Inc., JPMorgan Chase & Co. and Wells Fargo & Co. are set to kick off a Federal Reserve pilot program to measure how hurricanes, drought and other extreme weather events can affect their portfolios.

The central bank on Tuesday released details on how the new "climate scenario analysis exercise" will work. The measures mark the Fed's most concrete steps yet to ensure that banks are ready for risks brought on by a changing climate and severe weather events, as well as for the transition to an economy less reliant on fossil fuels. Banks must submit their analyses by July 31.

Unlike traditional stress tests, the climate program won't have capital or supervisory implications for the banks, according to the Fed. Bank of America Corp., Citigroup Inc. and Morgan Stanley will also take part.

"The exercise we are launching today will advance the ability of supervisors and banks to analyze and manage emerging climate-related financial risks," Vice Chair for Supervision Michael Barr said in a statement.

According to the Fed, the pilot program will involve:

- Different levels of severity on residential and commercial real estate portfolios for the northeastern US, and directs banks to consider the affect of additional "physical risk shocks" to real estate portfolios in another region of the country
- Impact on corporate loans, commercial real estate portfolios based on current

policies and a 2050 net zero greenhouse gas emissions horizon.
- Variables such as inflation rates in the US, UK, Europe and Japan, as well as housing prices and quarterly energy consumption.

Financial regulators have come under increasing scrutiny by Republicans for any action seen as veering into the realm of environmental, social and governance policymaking. House Republicans have vowed to bring in the likes of Securities and Exchange Commission Chair Gary Gensler to defend moves to get publicly traded companies, including banks, to disclose more to investors about climate risks and steps to reduce their carbon footprint.

Democrats have countered that regulators should be doing even more to address climate change.

Companies, particularly big bank lenders and money managers, are likewise under the microscope for their ESG policies, which some Republican politicians say lean too far to the left.

Barr has tried to keep out of the partisan debates, and Fed officials cast the pilot as a learning exercise looking at the different ways that big banks measure and manage risks to their portfolios.

Press Releases

McHenry Announces Financial Services Committee Republican ESG Working Group

Taps Huizenga to coordinate Republicans' approach to environmental, social, and governance proposals

Washington, February 3, 2023 -

Today, the Chairman of the House Financial Services Committee, Patrick McHenry (NC-10), announced the formation of a Republican Working Group—led by Oversight and Investigations Subcommittee Chairman Bill Huizenga (MI-04)—to combat the threat to our capital markets posed by those on the far-left pushing environmental, social, and governance (ESG) proposals.

"Progressives are trying to do with American businesses what they already did to our public education system—using our institutions to force their far-left ideology on the American people. Their latest tool in these efforts is environmental, social, and governance proposals. This is why I am creating a Republican ESG working group led by Oversight & Investigations Subcommittee Chair Bill Huizenga," **said Chairman McHenry.** *"This group will develop a comprehensive approach to ESG that protects the financial interests of everyday investors and ensures our capital markets remain the envy of the world. Financial Services Committee Republicans as a whole will continue our work to expand capital formation, hold Biden's rogue regulators accountable, and support American job creators."*

"Last year, the Supreme Court ruled in West Virginia vs EPA that government bureaucracies cannot arbitrarily expand their own regulatory reach," **said Congressman Bill Huizenga.** *"The SEC's climate disclosure rule is a prime example of this overreach- that would have a wide-ranging impact on hard working Americans across all walks of life. I look forward to leading our committee's ESG working group, which will focus on promoting strong, vibrant capital markets, while defending the interests of all retail investors."*

ESG Working Group Members

- Bill Huizenga (MI-04)
- Ann Wagner (MO-02)
- Barry Loudermilk (GA-11)
- Bryan Steil (WI-01)

- Andrew Garbarino (NY-02)
- Byron Donalds (FL-19)
- Monica De La Cruz (TX-15)
- Erin Houchin (IN-09)
- Andy Ogles (TN-05)

Background

The Financial Services Committee's Republican ESG Working Group is committed to protecting the financial interests of everyday investors and ensuring American capital markets remain the envy of the world.

To combat the threat posed to our free markets by far-left environmental, social, and governance proposals, the working group will examine ways to:

- Rein in the SEC's regulatory overreach;
- Reinforce the materiality standard as a pillar of our disclosure regime;
- And hold to account market participants who misuse the proxy process or their outsized influence to impose ideological preferences in ways that circumvent democratic lawmaking.

The working group will coordinate Republicans' response to the ESG movement through Member education and policy development across the Committee's jurisdiction and throughout the broader House Republican Conference.

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BLOOMBERG: Texas's Wall Street Showdown Costing Cities Hundreds of Millions
By: Amanda Albright and Danielle Moran

July 13, 2022

Texas taxpayers are footing the bill for the state's war with Wall Street over guns.

The state's municipal borrowers have been hit with as much as $532 million of extra debt costs because of a new GOP law that's led some banks to step back from Texas's bond market. That's the conclusion of a new paper by Daniel Garrett, a University of Pennsylvania professor, and Ivan Ivanov, a principal economist at the Federal Reserve.

The researchers examined sales in Texas's $50-billion-a-year municipal-bond market after a law took effect in September that targeted banks for their gun policies.

The legislation, known as Senate Bill 19, bars governments from entering into contracts with companies that "discriminate" against firearms entities. It has caused banks including Bank of America Corp. and JPMorgan Chase & Co., among the biggest underwriters of state and city debt nationwide, to stop most public-finance business in the state.

The study found that "the exit of the targeted underwriters from the Texas market has significant impact on underwriter competition and that the remaining banks are unable to offset the adverse effects of removing banks from the market." The result is "large adverse effects for borrowers."

The working paper offers an in-depth study into the cost borne by Texas governments after the law took effect. Market participants and opponents of the legislation have warned that Texas Republicans' move to punish the banks could raise expenses for cities, counties, school districts, and even the state itself, by reducing competition for bond sales.

Garrett, a finance professor at the University of Pennsylvania's Wharton School, said the magnitude of the increase in costs was unexpected given that Texas has a competitive muni market, with many underwriters participating.

"To see even the biggest issuers affected by this sort of shock was very surprising," Garrett said in an interview. The paper examined bond sales from September through April.

The research focused on the departure of firms including Bank of America, Citigroup Inc., Goldman Sachs Group Inc. and JPMorgan Chase from the Texas municipal market, which is second only to California's in terms of annual issuance.

Citigroup paused underwriting in Texas for several months, but has since underwritten sales. JPMorgan has been moving to re-enter the market as well.

The paper looked at borrowers that have historically relied on the affected banks. It compared bonds sold on the same day with similar credit profiles and structures to those issued by governments that haven't historically favored one of the impacted firms.

The study found that the more an issuer had relied on one of the banks that pulled back from the Texas market, the more governments paid when they had to switch. Issuers with over 50%

reliance on the affected banks saw a roughly 20% increase in borrowing costs as a result of the law, it concluded. The study stripped out daily market fluctuations, meaning the broad increase in long-term yields during the period didn't influence the outcome.

Garrett and Ivanov found that issuers affected by the law are avoiding selling bonds via auction, when underwriters compete for sales, a method that separate studies have shown reduces municipalities' borrowing costs. Instead, they're opting to hire underwriters in advance, the paper said.

And when they do sell via auction, they're seeing fewer bidders, the paper said.

"The number of underwriting bidders declines sharply, the variance among remaining bids increases, and the winning bid in terms of yield to maturity increases after the implementation of the Texas laws for issuers with previous reliance on the exiting banks," the paper said.

Meanwhile, the ranks of muni underwriters in Texas may get even thinner due to another new law, Senate Bill 13, which restricts governments from working with companies that "boycott" the fossil-fuels industry.

This measure, which also took effect in September, has caused some banks to lose out on Texas muni deals as issuers wait for the Republican state comptroller to decide which companies should be restricted under the law.

"If more banks leave, these costs will go up," the paper said.

Garrett and Ivanov will have a chance to get feedback on the paper next month, when they present it at the Brookings Institution's Municipal Finance Conference.