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Locke Lord QuickStudy: Texas Legislature to ESG: Don’t Mess ?With Texas ?

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The 88th Regular Session (2023) of the Texas Legislature voted to enact Senate Bill 833 (“SB 833”), ?which aims to prohibit ?insurers operating in Texas from using environmental, social, or governance ??(“ESG”) models, ?scores, factors, or standards to charge different rates to businesses or risks in the ?same class ?facing essentially the same hazards.? Because of the divergent approach states have taken regarding ESG issues, SB 833 may present unique challenges for insurance companies operating across ?multiple jurisdictions. To navigate this complex landscape, insurance companies need to develop ?flexible strategies ?that can accommodate the contrasting regulatory expectations in the states coined ??“anti-ESG” versus the “pro-ESG” states. This scenario not only involves ?managing legal and compliance ?risks but also managing reputational risks. ?

What is the purpose of SB 833?

According the Texas legislature, insurance companies are under pressure to stop providing coverage to the fossil fuel ?industry. Pointing to a campaign letter urging the ?CEOs of 30 major insurers to cease underwriting new fossil ?fuel projects and divest from fossil fuel companies, the legislature looks to combat such external pressures that could in their view negatively impact both insurance companies and policyholders by potentially impeding ?insurers’ ability to make sound business decisions based on risk.

SB 833 aims to address this issue by regulating the use of ESG ?models, scores, factors, or standards to prevent unfair discrimination in the insurance business ?within Texas. While the Texas legislature recognizes that various entities utilize diverse ESG models for ?evaluating financial risks for investments or to influence business transactions with specific ?industries, the legislature’s stated concern lies with the potential misuse of such models that lack a ?foundation in “sound actuarial principles” or do not maintain a reasonable relationship with ?expected insurance risks.

The purported intent of SB 833 is to prevent the misuse of ESG factors that could adversely impact the economy, ?competition, jobs, the environment, or public health and safety in Texas.

What are the requirements of SB 833?

Authorized insurers writing all lines of business in Texas, except fidelity, guaranty, and surety bonds and crop insurance, are prohibited from using an ESG model, score, factor, or standard to charge a different ?rate to another business or risk in the same class for essentially the same hazard. However, an exception applies if the insurer's actions align with ordinary insurance business ?purposes, including the application of "sound actuarial principles, or financial solvency ?considerations reasonably related to loss experience" for the various types of risks and coverages ?provided by the insurer.??

SB 833 does not require an insurer to write any line or type of business they do not currently write or mandate a significant change in the insurer's current business plans. Furthermore, it does not prohibit the use of information that is relevant and related to the risk being insured, even if that information may also be considered in developing an ESG model, score, factor, or standard.

SB 833 prohibits the Texas Department of Insurance from promulgating rules that require an insurer to use any ESG model, law, regulation, or standard that has not been specifically authorized under the bill. This includes any rule, model, or standard required under any federal law that does not preempt state law under the McCarran-Ferguson Act or any rule, model, or standard required by any national organization, such as the National Association of Insurance Commissioners.

Perhaps the most interesting part of SB 833 is what it does not contain, namely an expressly stated enforcement provision for insurers who fail to comply with its requirements. SB 833, which is set to be codified as new chapter 565 in the Texas Insurance Code, will take its place in Subtitle C, Deceptive, Unfair, and Prohibited Practices. Unlike the enforcement provisions in many of its neighboring chapters, insurers who violate SB 833 are not subject to express sanctions or administrative penalties under SB 833 and SB 833 does not create a private cause of action or independent basis in civil or criminal ?proceedings.? However, the Texas Department of Insurance can presumably enforce SB 833 via its general enforcement powers found in Texas Insurance Code Chapter 82.

Another interesting aspect of SB 833 is that it does not define "environmental, social, or governance" models, scores, factors, or standards-thus, leaving open to what extent any of the separate ESG factors (especially environmental risk) could or may be considered individually.

A Glimpse of Future Regulatory Landscape?

SB 833 offers a significant glimpse into potential future regulatory trends. At its core, the legislation serves as a stark reminder to insurers in Texas to base risk evaluations on sound actuarial principles and financial solvency considerations rather than external pressures. Moreover, its introduction signifies the Texas legislature's willingness to intervene in the face of perceived threats to business autonomy in the insurance sector. If insurers fail to adhere to these standards, it is plausible that future, more stringent regulations could be on the horizon. As such, SB 833 should not be dismissed as merely symbolic; instead, it should be viewed as a potential harbinger of more robust regulatory measures to come if insurers do not comply with the principles laid out in this bill.

If signed by the Texas Governor, SB 833 will become effective September 1, 2023, and applies to insurance policies delivered, issued for delivery, ?or renewed on or after January 1, 2024, by an insurer in Texas.

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