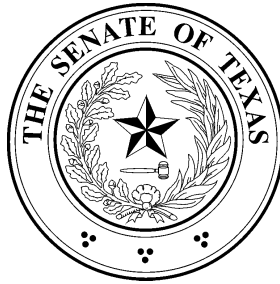


# **Senate Committee on State Affairs**

Interim Report

December 2022



December 29, 2022

The Honorable Dan Patrick  
Lieutenant Governor of the State of Texas  
Capitol Building, Room 2E.13  
Austin, Texas 78701

Dear Lieutenant Governor Patrick:

You charged the Senate Committee on State Affairs with reviewing several issues within the Committee's jurisdiction. We submit this report in response to those charges.

Respectfully submitted,

Handwritten signature of Bryan Hughes in black ink.

Bryan Hughes, Chair

Handwritten signature of Brian Birdwell in black ink.

Brian Birdwell

Handwritten signature of Paul Bettencourt in black ink.

Paul Bettencourt

Handwritten signature of Donna Campbell in black ink.

Donna Campbell

Handwritten signature of Bob Hall in black ink.

Bob Hall

Handwritten signature of Lois Kolkhorst in black ink.

Lois Kolkhorst

Handwritten signature of Eddie Lucio, Jr. in black ink.

Eddie Lucio, Jr.



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Charles Schwertner



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Judith Zaffirini

Vice Chair, Natural Resources and  
Economic Development  
Texas Judicial Council  
Chair, Eagle Ford Shale  
Legislative Caucus



**Judith Zaffirini**  
State Senator, District 21  
President Pro Tempore, 1997

**Committees**  
Higher Education  
Local Government  
State Affairs

December 27, 2022

The Honorable  
Bryan Hughes, Chair  
Senate Committee on State Affairs  
P.O. Box 12068  
Austin, TX 78701

Dear Chair Hughes:

Thank you for your leadership as Chair of the Senate Committee on State Affairs. Although I support this report's recommendations, I am concerned about potential government overreach regarding investment practices that could have unintended consequences harming our pensioners and economy. As the report acknowledges, current law requires investment managers to discharge their duties solely in the interest of the participants and beneficiaries. Accordingly, when investing public retirees' money, asset managers already have a fiduciary duty and must consider only financial factors to maximize returns. Environmental, social, and governance considerations may be relevant if they have a material impact on financial returns during the relevant time horizon.

What's more, public pension plan boards of trustees also must be mindful of their existing authority. If they have not done so already, trustees should issue express investment guidelines to instruct the investment management services their asset managers and advisors provide. Equally important, if trustees disagree with the proxy votes taken on their behalf by their asset managers, they can and should consider taking back their vote and voting those shares directly.

Finally, the decision to retain or remove any asset manager must remain solely in the hands of the trustees in accordance with their fiduciary duties to the plan and their participants. Trustees should continue to hire asset managers with a track record of delivering low-fee, highly rated, and outperforming investment strategies to obtain the best risk-adjusted returns for their retirees, which current evidence suggests they have been doing well.

Thank you for your dedication to the many important issues we examined during the 87<sup>th</sup> Interim. I look forward to continuing to work with you and other members of the committee during our next legislative session.

My prayer is that the Lord will bless you and inspire you always.

Very truly yours,

A handwritten signature in cursive script that reads "Judith Zaffirini".

Judith Zaffirini

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## INTERIM CHARGES

The Senate Committee on State Affairs was charged with seven interim charges by the Lieutenant Governor. The Committee held interim hearings on the following charges:

1. **Human Trafficking:** Examine opportunities and make recommendations to reduce the profitability of and demand for human trafficking in Texas. Determine ways to increase public awareness of the proliferation of human trafficking, as well as resources for victims and survivors. Monitor the implementation of House Bill 1540 (87th Legislature) and examine changes in arrest rates, judicial dispositions, and sentencing amongst offenders due to provisions of the legislation. Examine opportunities for attorneys to combat human trafficking in their local communities, including use of the Deceptive Trade Practices Act, to generate revenue for local law enforcement officials combatting human trafficking. Make any other recommendations to further prevent human trafficking.
2. **Privacy and Transparency:** Review the current state laws that protect and secure individuals' biometric identifiers. Explore ways to protect against the use of biometric identifiers for unintended purposes without an individual's consent and make recommendations to the Senate. Study websites that closely resemble government websites or fraudulently represent companies that they are not, including websites that use names of state agencies or licenses. Make recommendations to ensure that Texans' are not misled, taken advantage, or defrauded, especially when they try to seek assistance from a state website.
3. **Investment Practices:** Study the investment practices of financial services firms and how those practices affect the state's public pensions. Make recommendations to ensure the state's public pension funds are not being invested to further political or social causes.

## **SENATE COMMITTEE ON STATE AFFAIRS INTERIM HEARINGS**

May 25, 2022, *Senate Chamber*

The Committee took invited and public testimony on Charge Nos. 1, 2, and 3.

December 15, 2022, *Historic Harrison County Courthouse, Marshall, Texas*

The Committee took invited and public testimony on Charge No. 3 and the related subpoena.

# INTERIM CHARGE DISCUSSIONS AND RECOMMENDATIONS

## CHARGE NO. 1

**Human Trafficking:** *Examine opportunities and make recommendations to reduce the profitability of and demand for human trafficking in Texas. Determine ways to increase public awareness of the proliferation of human trafficking, as well as resources for victims and survivors. Monitor the implementation of House Bill 1540 (87th Legislature) and examine changes in arrest rates, judicial dispositions, and sentencing amongst offenders due to provisions of the legislation. Examine opportunities for attorneys to combat human trafficking in their local communities, including use of the Deceptive Trade Practices Act, to generate revenue for local law enforcement officials combatting human trafficking. Make any other recommendations to further prevent human trafficking.*

### **Background**

Human Trafficking is a crime of exploitation that can occur in any industry and does not require physical movement or transportation of a victim from one location to another.<sup>1</sup> Trafficking occurs where there is labor or sexual exploitation by means of force, fraud, or coercion, or where there is commercial sexual exploitation of a child.<sup>2</sup> Historically ranked by the National Human Trafficking Hotline as number two in the nation for human trafficking case reports, Texas was again ranked second in 2020 for the number of trafficking cases reported.<sup>3</sup>

Despite these challenges, Texas continues to be a leader in the effort to combat human trafficking. Over the past few sessions of the Legislature, the Legislature has increased criminal penalties for traffickers and created an offense of solicitation of prostitution, which makes Texas the first in the nation to make solicitation a felony.<sup>4</sup>

The State has provided prevention training opportunities to law enforcement officers,<sup>5</sup> health care practitioners,<sup>6</sup> hotel employees,<sup>7</sup> and public school employees,<sup>8</sup> and increased resources and protections for survivors, including through treatment programs,<sup>9</sup> nondisclosure orders,<sup>10</sup> and new civil remedies.<sup>11</sup> In 2018, the Attorney General Human Trafficking division helped permanently

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<sup>1</sup> *Fiscal Year 2022 Report of Annual Activities*, Texas Human Trafficking Prevention Task Force (compiled by the Office of the Attorney General) (December 2022).

<sup>2</sup> *Id* at 6.

<sup>3</sup> *Hotline Statistics for 2020*, National Human Trafficking Hotline (2020).

<sup>4</sup> *E.g.*, Tex. H.B. 1540, 87th Leg., R.S., (2021), Tex. S.B. 20, 86th Leg., R.S., (2019); Tex. H.B. 29, 85th Leg., R.S. (2017); Tex. H.B. 10, 84th Leg., R.S. (2015).

<sup>5</sup> Tex. H.B. 292, 86th Leg., R.S., (2019).

<sup>6</sup> Tex. H.B. 2059, 86th Leg., R.S. (2019).

<sup>7</sup> Tex. H.B. 390, 87th Leg., R.S. (2021).

<sup>8</sup> Tex. H.B. 403, 86th Leg., R.S., (2019); Tex. H.B. 111, 86th Leg., R.S., (2019).

<sup>9</sup> Tex. S.B. 20, 86th Leg., R.S., (2019).

<sup>10</sup> Tex. S.B. 20, 86th Leg., R.S., (2019).

<sup>11</sup> Tex. H.B. 2552, 85th Leg., R.S., (2017) (amending TEX. BUS. & COM. CODE § 17.46(b)); Tex. S.B. 1196, 85th Leg., R.S., (2017) (amending TEX. CIV. PRAC. & REM. CODE § 125.0015); Tex. H.B. 533, 81st Leg., R.S., (2009) (adding TEX. CIV. PRAC. & REM. CODE Chapter 98).



shut down Backpage.com, the largest online sex trafficking marketplace in the world.<sup>12</sup> In fiscal year 2022, the Texas Department of Public Safety has made 1,746 arrests for solicitation of prostitution.<sup>13</sup>

While Texas has accomplished a great deal in the war against human trafficking, the problem is certainly complex and the state should continue to make ending human trafficking a top priority.

## Discussion

### A. Profitability of and Demand for Human Trafficking

As with any commercial market, three components make up the commercial sex market: supply, providers, and demand. Like the market for any other product, demand is the driving force.<sup>14</sup> While each component is subject to criminal penalties,<sup>15</sup> the risk of penalty alone has not been sufficient to end sex trafficking in this state, and as the public's understanding of this crime has evolved, so too has the desire to shift prosecutions away from victims to those who are truly responsible -- the providers and buyers.<sup>16</sup> The state should continue to apply basic economic principles to disrupt the commercial sex market by reducing the demand for commercial sex.

#### 1. Illicit Massage Businesses

Illicit massage businesses (IMBs) are still the most common venue for sex trafficking nationwide and in Texas.<sup>17</sup> IMBs claim to offer massage services but are in fact fronts for prostitution and human trafficking.<sup>18</sup> Most IMBs occupy leased commercial space to allow the owners to easily relocate if they come under pressure from law enforcement.<sup>19</sup> Children at Risk's mapping of suspected IMBs found that many are located in affluent areas and within a mile of schools.<sup>20</sup> Compared to other models of human trafficking, the IMB model presents a much easier business model for law enforcement to target because IMBs operate and advertise, at least on the surface, as legitimate businesses with physical locations and licenses.

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<sup>12</sup> *Investigation by AG Paxton's Office Helps Shut Down Backpage.com*, TEX. ATT'Y GEN. (Apr. 9, 2018), <https://www.texasattorneygeneral.gov/news/releases/investigation-ag-paxtons-office-helps-shut-down-backpagecom-0>.

<sup>13</sup> *Fiscal Year 2022 Report of Annual Activities: Arrest Data*, Texas Human Trafficking Prevention Task Force (compiled by the Office of the Attorney General) (December 2022).

<sup>14</sup> *Id.*

<sup>15</sup> TEX. PENAL CODE Chapter 20A; TEX. PENAL CODE §§ 43.02, 43.03, 43.031, 43.04, 43.041, 43.05.

<sup>16</sup> See Tex. H.B. 1540, 87th Leg., R.S. (2021) (creating a felony offense for solicitation of prostitution).

<sup>17</sup> *Hotline Statistics*, NAT'L HUM. TRAFFICKING HOTLINE, <https://humantraffickinghotline.org/states> (last visited Oct. 28, 2020); *Texas*, NAT'L HUM. TRAFFICKING HOTLINE, <https://humantraffickinghotline.org/state/texas> (last visited Oct. 28, 2020).

<sup>18</sup> *Human Trafficking Charge: Hearing Before the S. Comm. on State Affairs*, 2022 Leg., 87th Interim (March 25, 2022) (written testimony of Caroline Roberts, Children at Risk).

<sup>19</sup> Sanborn et al., *supra* note 49, at 5; *Human Trafficking in Illicit Massage Businesses*, *supra* note 20, at 70.

<sup>20</sup> *Human Trafficking Charge: Hearing Before the S. Comm. on State Affairs*, 2022 Leg., 87th Interim (March 25, 2022) (written testimony of Caroline Roberts, Children at Risk).

## 2. Buyers

It is necessary that efforts to reduce demand for human trafficking focus on the people creating the demand: buyers of commercial sex. Last session, HB 1540 was passed to tackle this very issue. HB 1540 created the felony offense of solicitation of prostitution, making Texas the first state to make this a felony.<sup>21</sup> To date, 1,746 arrests have been made under this new law.<sup>22</sup>

Research indicates that a perceived risk of arrest has a diminishing effect on sex buying,<sup>23</sup> and so shifting law enforcement focus from arresting human trafficking victims for selling prostitution to arresting those who buy prostitution will help reduce human trafficking in this state.

## 3. Current State Efforts to Reduce Profitability and Demand

The Texas Department of Licensing and Regulation's (TDLR) Anti-Trafficking Unit is one state effort to reduce the demand for and profitability of human trafficking. TDLR has made identifying and shutting down IMBs a top priority for the agency that licenses legitimate massage businesses. TDLR's Anti-Trafficking Unit is a highly trained investigative unit that conducts unannounced inspections of any business that advertises massage services, even unlicensed massage businesses.<sup>24</sup> The agency also conducts a national fingerprint-based criminal history check of all massage therapists, massage establishment owners, and massage school owners, combs the Internet for businesses advertising illicit massage services, and coordinates with local, state, and federal law enforcement agencies.<sup>25</sup> TDLR's Anti-Trafficking Unit has identified over 1,000 potential high-risk massage establishments through continued statewide investigative inspections.<sup>26</sup>

Even though IMBs are the most common venue for human trafficking, human trafficking also regularly occurs in establishments that the Texas Alcoholic Beverage Commission (TABC) regulates, like bars, clubs, and hotels. The TABC Special Investigations Unit works to identify criminal activity in TABC businesses and partners with other law enforcement agencies to share intelligence and make arrests, cutting off key funding for traffickers and businesses that enable trafficking by revoking their alcohol permits and shutting down the businesses.<sup>27</sup> With the passage of HB 1540, TABC investigators now have the ability to use the investigative tool of drink solicitation.<sup>28</sup> Drink solicitation is the criminal activity of engaging a customer to purchase alcohol for consumption at an inflated price. This practice is routinely used as a gateway for prostitution, often in concert with human trafficking. Adding drink solicitation to the listed offenses that would

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<sup>21</sup> Tex. H.B. 1540, 87th Leg., R.S. (2021).

<sup>22</sup> *Human Trafficking Charge: hearing Before the S. Comm. on State Affairs*, 2022 Leg., 87th Interim (May 25, 2022) (written testimony of Cara Pierce, Office of the Attorney General Human Trafficking and Transnational/Organized Crime Division).

<sup>23</sup> *Who Buys Sex? Understanding and Disrupting Illicit Market Demand*, *supra* note 46, at 27, 30.

<sup>24</sup> *TDLR Human Trafficking Response at a Glance*, TEX. DEP'T LICENSING & REG. (Oct. 2019), <https://www.tdlr.texas.gov/media/pdf/Human%20Trafficking%20Response%20at%20a%20Glance.pdf>.

<sup>25</sup> *Id.*; see also TEX. OCC. CODE § 455.1525.

<sup>26</sup> *Fiscal Year 2022 Report of Annual Activities: Report on Task Force Member Initiatives and Collaborations*, Texas Human Trafficking Prevention Task Force (compiled by the Office of the Attorney General) (December 2022).

<sup>27</sup> *Human Trafficking Charge: Hearing Before the S. Comm. on State Affairs*, 2020 Leg., 86th Interim (Feb. 26, 2020) (written testimony of Chairman Kevin J. Lilly, Texas Alcoholic Beverage Commission).

<sup>28</sup> Tex. H.B. 1540, 87th Leg., R.S. (2021).

deny a license or permit to a person at a location, provides another avenue to crack down on human trafficking.

## **B. Public Awareness and Resources for Victims**

Public awareness and victim services are critical in preventing the exploitation of human trafficking victims, identifying a victim who is being exploited, and helping victims to break the cycle of dependence and exploitation and begin the process of recovery.

### **1. Public Awareness**

Public awareness is essential to the fight against human trafficking. State law increases public awareness of human trafficking primarily in two ways: public postings and required trainings. Establishments that trafficking victims may frequent, like sexually oriented businesses, transportation hubs, and massage businesses, are required to post signs with the national human trafficking hotline number.<sup>29</sup> Last session, HB 3721 was passed which now requires these signs to include how to report suspicious activity to the Texas Department of Public Safety.<sup>30</sup>

State law also requires some individuals who, through their occupation, may interact with trafficking victims or potential victims to undergo training. Required trainings provide information about types of human trafficking, recognizing warning signs, identifying victims, and responding appropriately to assess the needs of victims.<sup>31</sup> Texas schools are now required to provide age-appropriate, research-based education designed to prevent child sexual abuse and trafficking.<sup>32</sup> Hotels are now required to have their employees undergo yearly training on human trafficking.<sup>33</sup> Additionally, as a result of the passage of SB 1831 (Julia Wells Act) a human trafficking prevention course is required in all driver education courses.<sup>34</sup>

### **2. Resources for Victims**

Because trafficking victims rarely seek help, screening tools that identify potential victims continue to be critical to discovering victims and their traffickers. The Governor's Child Sex Trafficking Team has worked to promote the widespread use of the Commercial Sexual Exploitation – Identification Tool (CSE-IT).<sup>35</sup> The CSE-IT is an research-based screening tool that facilitates early identification of commercially sexually exploited youth (CSEY) that a teacher,

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<sup>29</sup> TEX. BUS. & COM. CODE § 102.101; TEX. GOV'T CODE § 402.0351; TEX. OCC. CODE § 455.207. Among six categories of state investment in ending human trafficking, one study found the “most important provisions to increase human trafficking arrests are requiring the National Human Trafficking Hotline number to be posted in public places.” Vanessa Bouché, Amy Farrell, & Dana Wittmer, *Identifying Effective Counter-Trafficking Programs and Practices in the U.S.: Legislative, Legal, and Public Opinion Strategies that Work*, NAT'L CRIM. JUST. REFERENCE SERV., 17 (Jan. 2016), <https://www.ncjrs.gov/pdffiles1/nij/grants/249670.pdf>.

<sup>30</sup> Tex. H.B. 3721, 87th Leg., R.S., (2021).

<sup>31</sup> See, e.g., *SOAR to Health and Wellness*, TRAIN LEARNING NETWORK, <https://www.train.org/main/course/1087568/> (last visited Oct. 30, 2020).

<sup>32</sup> 19 Tex. Admin. Code § 61.1051 (2019) (Tex. Educ. Agency, Reporting Child Abuse or Neglect, Including Trafficking of a Child).

<sup>33</sup> Tex. H.B. 390, 87th Leg., R.S., (2021).

<sup>34</sup> Tex. S.B. 1831, 87th Leg., R.S., (2021).

<sup>35</sup> *Human Trafficking Charge: Hearing Before the S. Comm. on State Affairs*, 2022 Leg., 87th Interim (May 25, 2022) (written testimony of Hillary England, Office of the Governor).

doctor, child welfare worker, or other professional can administer.<sup>36</sup> Based on answers to survey questions, the CSE-IT ranks a child from “no concern” to “possible concern” to “clear concern” for commercial sexual exploitation.<sup>37</sup> Between 2016 and 2022, over 72,000 screenings of youth have been completed with approximately 12% scoring as “clear concern,” which is the highest probability for having experienced commercial sexual exploitation.<sup>38</sup> Identifying a child as “clear concern” can trigger access to services available for exploited minors and are eligible for a wide array of grant funded services, including long-term advocacy and case management.<sup>39</sup>

Many state agencies provide resources for human trafficking victims. The Governor's Public Safety Office has awarded more than \$85,000,000 in grants to combat human trafficking.<sup>40</sup> The overwhelming majority of these grants provide critical services to victims, including specialized residential programs, drop-in centers, case management, and counseling.<sup>41</sup> To date, the Governor's Public Safety Office now funds 16 specialized CSEY Advocacy programs with services across 106 counties.<sup>42</sup> These advocacy agencies provide around-the-clock crisis response and ongoing relational support to survivors until age 22.<sup>43</sup>

For youth who are in the conservatorship of DFPS or who are trafficked by a family member or guardian, the Human Trafficking and Child Exploitation division collaborates with children's advocacy centers to provide victim services.<sup>44</sup> DFPS provides the highest foster care funding rate (Intense Plus level of care) for children who have been trafficked or suffered other severe trauma.<sup>45</sup>

The Health and Human Services Commission (HHSC), in collaboration with a health-related institution of higher education, is establishing an inpatient and outpatient child sex trafficking treatment program.<sup>46</sup>

In addition to the resources that state agencies provide, many nonprofit organizations deliver a wide array of services to victims in Texas. From prevention to crisis intervention to long-term housing and recovery resources, nonprofit organizations across the State and thousands of volunteers work together to combat human trafficking and help victims.

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<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> *Human Trafficking Charge: Hearing Before the S. Comm. on State Affairs*, 2020 Leg., 86th Interim (Feb. 26, 2020) (testimony of Blanca Denise Lance, Director, Human Trafficking and Child Exploitation division, Texas Department of Family and Protective Services).

<sup>45</sup> *Service Levels for Foster Care*, TEX. DEP'T FAM. & PROTECTIVE SERVS., [https://www.dfps.state.tx.us/Child\\_Protection/Foster\\_Care/Service\\_Levels.asp](https://www.dfps.state.tx.us/Child_Protection/Foster_Care/Service_Levels.asp) (last visited Oct. 30, 2020).

<sup>46</sup> *Human Trafficking Charge: Hearing Before the S. Comm. on State Affairs*, 2020 Leg., 86th Interim (Feb. 26, 2020) (testimony of Dee Budgewater, Health and Human Services Commission, discussing implementation of TEX. HEALTH & SAFETY CODE Chapter 50, as added by Tex. S.B. 20, 86th Leg., R.S., (2019)).

As important as victim services have always been to helping victims recover and rebuild their lives, these services are even more important today as economic challenges are exacerbating the problem of human trafficking.

### **C. HB 1540 Implementation**

As a result of legislative recommendations from the Texas Human Trafficking Prevention Task Force, HB 1540 was passed in the 87th Regular Session as a human trafficking omnibus.<sup>47</sup> HB 1540 expanded the list of investigative tools available such as drink solicitation, prevented the toleration of trafficking by an individual or enterprise's agent, increased residential treatment and emergency center protections for victims, and established the felony offense of solicitation of prostitution.<sup>48</sup>

By passing HB 1540, Texas became the first state to make buying sex from an adult a felony offense. HB 1540 created the offense of solicitation of prostitution, which occurs when someone knowingly offers or agrees to pay a fee to another for sexual conduct. If convicted, defendants face 180 days to 2 years in jail.<sup>49</sup> As a result of the passage HB 1540, 1,746 arrests in fiscal year 2022 have been made.<sup>50</sup>

### **D. Use of the Deceptive Trade Practices Act**

Business and Commerce Code Section 17 lays out Texas' Deceptive Trade Practices Act (DTPA). The purpose of the Act is to protect Texans from business practices that are false, deceptive, or misleading and provides an avenue to legal recourse for victims.

The DTPA also allows for the Consumer Protection Division of the Office of the Attorney General to step in to prosecute businesses or individuals who use "false, misleading, or deceptive acts or practices in the conduct of any trade of commerce."<sup>51</sup> These illegal acts or practices include owning, operating, maintaining, or advertising a massage establishment that is not appropriately licensed or otherwise not in compliance with licensing regulations or local ordinances.<sup>52</sup>

According to the Office of the Attorney General, the DTPA can be and has been used as an effective tool to protect Texans from human trafficking as it relates to illegal massage businesses.<sup>53</sup>

### **E. Interim Hearing**

On May 25, 2022, the Senate Committee on State Affairs held an interim hearing covering the human trafficking charge. Invited testimony included representatives from the Office of the Governor, Office of the Attorney General, Texas Department of Licensing and Regulation,

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<sup>47</sup> Tex. H.B. 1540, 87th Leg., R.S., (2021).

<sup>48</sup> *Id.*

<sup>49</sup> Tex. H.B. 1540, 87th Leg., R.S., (2021).

<sup>50</sup> *Fiscal Year 2022 Report of Annual Activities: Arrest Data*, Texas Human Trafficking Prevention Task Force (compiled by the Office of the Attorney General) (December 2022).

<sup>51</sup> Business and Commerce Code Sec. 17.46(a).

<sup>52</sup> Business and Commerce Code Sec. 17.46(b)(33).

<sup>53</sup> *Illicit Massage Businesses and Human Trafficking in Texas*, Office of the Attorney General (May 10, 2022) (slideshow provided to the Senate Committee on State Affairs).

Children's Advocacy Centers of Texas, Texas Association Against Sexual Assault, and Children at Risk.

### **1. Office of the Attorney General**

Cara Pierce, the Chief of the Office of the Attorney General's Human Trafficking and Transnational/ Organized Crime Division highlighted successes from the 87th Legislature's work, such as HB 1540, noting that in fiscal year 2022, there have been 1,068 arrests made (this number has now risen to 1,746 arrests)<sup>54</sup> under the bill's new felony offense of solicitation of prostitution.

She expressed that in 2020 there were 1.7 million online sex advertisements in Texas, since HB 1540 was passed, it has gone down to 1.5 million advertisements. She expressed that the goal of HB 1540 to deter buyers is working and that other states are taking Texas' lead.

Steven Robinson, Chief of the Consumer Protection Division, spoke on the legal tools that are available to shut down IMBs. He also spoke on the use of the DTPA to stop IMBs from operating and gave specific examples of businesses that have been shut down.

### **2. Texas Department of Licensing and Regulation**

Mary Winston, the Manager of the Human Trafficking Unit, highlighted issues TDLR has been facing regarding regulating massage businesses and schools, the nexus of massage businesses and human trafficking, and how TDLR is combating those concerns. TDLR's Human Trafficking Unit responds to complaints in the businesses they regulate and works with TDLR partners to prevent human and labor trafficking. Ms. Winston also noted TDLR's partnership with the Human Trafficking Coordinating Council. TDLR has reported over 140 reports to their law enforcement division and the Office of the Attorney General. She also noted that as a result of the work of the Human Trafficking Unit and local law enforcement, 42 establishments have been closed, 27 arrests have been made, and there have been 11 outcries.

Mike Arismendez, the Executive Director of the Texas Department of Licensing and Regulation, thanked the committee on their work on human trafficking and reiterated TDLR's work with the Attorney General's Office and local law enforcement. He also expressed TDLR's interest in becoming a larger player in this arena.

### **3. Office of the Governor**

Hillary England, the Director of Trafficking and Sexual Violence Prevention Programs with the Office of the Governor, spoke on the need for adequate and accurate public awareness and education in the fight against human trafficking. One example she gave was Cecilia Abbott's initiative called "Can You See Me?". She highlighted the grant funding the Office of the Governor facilitates to advocacy groups to provide services such as case management and counseling to victims and the expansion of local advocacy centers.

### **4. Children's Advocacy Centers of Texas**

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<sup>54</sup> *Human Trafficking Charge: hearing Before the S. Comm. on State Affairs, 2022 Leg., 87th Interim (May 25, 2022)* (written testimony of Cara Pierce, Office of the Attorney General Human Trafficking and Transnational/ Organized Crime Division).

Justin Wood, Vice President of External Relations and General Counsel for Children's Advocacy Centers of Texas, spoke on their role as the membership association of the local advocacy centers across Texas. Mr. Wood spoke on the expansion of their centers into more counties, reaching more children.

He spoke on their model that incorporates all aspects of the process to healing for victims, such as health care workers and social workers, to ensure that these children have a comprehensive path forward to be free from their trafficker and the resulting trauma.

## **5. Texas Association Against Sexual Assault**

Michael Sweeney, the Human Trafficking Specialist with the Texas Association Against Sexual Assault (TAASA), spoke on their recommendations. He specifically mentioned increasing public awareness, ensuring accurate reporting, and meeting the immediate needs of the victims who may not be interested in being saved. He applauded Texas' efforts in being first in so many efforts to combat human trafficking such as the requirement to take a class on human trafficking awareness when receiving your CDL.

He recommended the City of Denver's approach to responding to run aways by creating a packet on that child and dispersing it across the state.

## **6. Children at Risk**

Caroline Roberts, Senior Staff Attorney with Children at Risk, spoke on the growth of IMBs across the state and the fact that the number has doubled in the last four years.<sup>55</sup> She recommended passing legislation that would allow local county and district attorneys to collect penalty fees against IMBs in violation of the DTPA.<sup>56</sup> She testified that this money would go back to localities and would incentivize local investigation and prosecution.

She also spoke on the fact that IMBs are primarily cash-only businesses with ATMs in the business that are being used to fund illegal sex and human trafficking. Ms. Roberts recommended the refiling of HB 2629, which would have required the registration of privately owned ATMs, thereby allowing for an avenue to identify owners and hold them accountable.

## **Recommendations**

### **A. Reduce Demand and Profitability**

#### **1. Continue to Stop IMBs and other venues that allow human trafficking**

Human trafficking is an illicit economy fueled by demand. Without demand, human trafficking would cease to exist. To reduce demand for and profitability of human trafficking, the state should continue to take action to make venues for human trafficking more difficult to operate. Because many IMBs are owned by shell companies to hide the true identity of the owners, the state should further evaluate requiring massage business to register official operators and primary owners with

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<sup>55</sup> *Human Trafficking Charge: Hearing Before the S. Comm. on State Affairs, 2022 Leg., 87th Interim (May 25, 2022)* (oral testimony of Caroline Roberts, Children at Risk).

<sup>56</sup> This legislation was filed in the 87th Regular Legislative Session as SB 1214.

valid phone numbers and addresses so that law enforcement agents can easily identify corporate owners.

The state should further consider requiring ATM registration with similar ownership and location data as other types of business registrations and penalize the owner if the owner changes the location of the ATM without updating the registration. Law enforcement can use these ATM records to help develop cases against traffickers and uncover other illicit activity like money laundering.

## **2. Continue to utilize the DTPA in the fight against Human Trafficking**

To reduce human trafficking through the operation of IMBs, the Office of the Attorney General should continue to use the DTPA to protect Texans from human trafficking. Some have suggested allowing local county and district attorneys to also pursue penalties against local IMBs in violation of the DTPA. In the regular session of the 87th Legislature, Senator Huffman introduced SB 1214 which would have allowed local county and district attorneys to collect penalty fees against IMBs in violation of the DTPA. This bill could provide funds to law enforcement and local attorneys to further incentivize the investigation and prosecution of IMBs.<sup>57</sup>

The state should continue to pursue ways to utilize the DTPA in the fight against human trafficking.

## **3. Continue to focus Law Enforcement efforts on buyers**

To further reduce the demand for human trafficking, the state should continue its work on adequately punishing buyers. HB 1540 established the new offense of solicitation of prostitution with the Texas Department of Public Safety making a large number of arrests as a result. Although great strides have been made in this area, the state should continue to train law enforcement and prosecutors to focus their investigations on buyers instead of victims.

### **B. Increase Public Awareness and Victim Services**

#### **1. Require trainings in fields likely to come into contact with victims**

The state has already increased public awareness on human trafficking exponentially with required trainings in the occupations most likely to come into contact with victims. The state should continue to partner with prosecutors, law enforcement agents, and nonprofit organizations to provide trainings among other industries likely to come into contact with victims, such as hotels, convenience stores, and oil and gas industries. Local and statewide task forces should invite members of the media to participate in task force operations to learn more about the issue.

#### **2. Continue to expose and eliminate IMBs**

In addition to the work to increase public awareness on human trafficking, over the past few years, the Office of the Attorney General has notified landlords of potential IMBs on their properties. The types of red flags that suggest the presence of a potential IMB include: primarily female

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<sup>57</sup> *Written testimony of Children at Risk for Human Trafficking Charge: Hearing Before the S. Comm. on State Affairs, 2022 Leg., 87th Interim (May 25, 2022).*



employees, workers living at the business, workers transported to the location by the owner or manager, "massage therapists" who are unlicensed, mostly male customers, and customers parking away from the business and watching for law enforcement.<sup>58</sup> As a result, the Office of the Attorney General has notified 34 landlords of these potential industries on their property, which has resulted in the closure of 17 IMBs.<sup>59</sup>

Current law allows landlords to seek forcible eviction upon a reasonable belief that a tenant is engaging in prostitution or human trafficking on the premises. However, the state should continue to find ways to require or incentivize landlords to terminate their leases with these businesses, thereby limiting the locations where IMBs operate.

### **3. Increase victim services**

Victims of human trafficking suffer complex, life-altering trauma and deserve comprehensive resources that will allow them to leave their trafficker, start the healing process from their trauma, and begin a new life. Numerous state agencies and nonprofit organizations are already working toward these goals, but more can always be done to help victims.

The state should continue to financially support and work with nonprofit organizations to provide more emergency shelters for victims removed from a trafficking situation, drop-in centers for youth experiencing homelessness, and long-term housing and financial support for victims on their way to recovery.

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<sup>58</sup> *Illicit Massage Businesses and Human Trafficking in Texas*, Office of the Attorney General (May 10, 2022) (slideshow provided to the Senate Committee on State Affairs).

<sup>59</sup> *Fiscal Year 2022 Report of Annual Activities: Report on Task Force Member Initiatives and Collaborations*, Texas Human Trafficking Prevention Task Force (compiled by the Office of the Attorney General) (December 2022).

## **CHARGE NO. 2**

**Privacy and Transparency:** *Review the current state laws that protect and secure individuals' biometric identifiers. Explore ways to protect against the use of biometric identifiers for unintended purposes without an individual's consent and make recommendations to the Senate. Study websites that closely resemble government websites or fraudulently represent companies that they are not, including websites that use names of state agencies or licenses. Make recommendations to ensure that Texans' are not misled, taken advantage, or defrauded, especially when they try to seek assistance from a state website.*

### **Background**

Cyber attacks and malicious cyber activity have grown rapidly over the last several years. In 2021, the United States experienced an unprecedented increase in cyber attacks and malicious cyber activity.<sup>60</sup> That year, the FBI received 847,376 reported cyber-related complaints--a 7% increase from 2020, with potential losses exceeding \$6.9 billion.<sup>61</sup> Texas alone faces billions of cyber attacks on a daily basis.<sup>62</sup>

Unfortunately, the COVID-19 pandemic brought on even more internet fraud. According to the San Angelo Standard-Times, the FBI's Internet Crime Complaint Center received and reviewed more than 3,600 complaints related to COVID-19 scams, many of which operated from websites that advertised fake vaccines and cures, operated fraudulent charity drives, delivered malware, or hosted various other types of scams.<sup>63</sup> Several of these involved false websites that spoofed government programs and organizations to lure people into providing their personal identifiable information and bank details.<sup>64</sup> Another incident occurred when the IRS notified the public of websites to apply for COVID-19 related stimulus checks. Soon after, the FBI found a number of fraudulent "look-alike" IRS stimulus payment domains, and alerted numerous domain registries and registrars to the existence of these look-alike URLs.<sup>65</sup> The Federal Trade Commission reported that more than \$321 million was lost to stimulus-related scams.<sup>66</sup> Google also announced that more than 150,000 fraudulent stimulus check websites launched after the first stimulus payments were announced, and that it had blocked more than 18 million scam emails every day since.<sup>67</sup>

With the heightened cyber threats and the constantly changing cyber crime and technology, Texas must stay pro-active in protecting its citizens and businesses. Some of the main ways the State can do so are by continuing to ensure individuals' biometric identifiers are not used without their consent; educating Texans on signs of fraudulent cyber activity; and providing resources and training to state and local government entities to prevent cyber attacks or aid in recovery after an attack occurs.

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<sup>60</sup> Federal Bureau of Investigation Internet Crime Report 2021, p.3,  
[https://www.ic3.gov/Media/PDF/AnnualReport/2021\\_IC3Report.pdf](https://www.ic3.gov/Media/PDF/AnnualReport/2021_IC3Report.pdf)

<sup>61</sup> *Id.*

<sup>62</sup> SB 475 (87th Reg.), Chair Jane Nelson, Sen. Comm on Finance, 4.7.21 hearing, part 1 (approx. 39:38)

<sup>63</sup> San Angelo Standard-Times, "Justice Dept. working to disrupt COVID-19 scams," (April 23, 2020)

<sup>64</sup> *Id.*

<sup>65</sup> *Id.*

<sup>66</sup> Sugar Land Sun, Dellinger, Hannah, "Scammers eye stimulus checks," (March 7, 2021).

<sup>67</sup> *Id.*

## Current Law on Biometric Data

State law makes several provisions to protect individuals' biometric data from disclosure by governmental bodies and private companies. Texas Government Code defines "biometric identifiers" to include "a retina or iris scan, fingerprint, voiceprint, or record of hand or face geometry."<sup>68</sup> The Business and Commerce Code provides a similar meaning when it defines "personal identifying information" to encompass a person's "unique biometric data, including the individual's fingerprint, voice print, and retina or iris image."<sup>69</sup>

### A. Government Entities

Governmental bodies, including those in or created by the judicial branch,<sup>70</sup> are prohibited from selling, leasing, or otherwise disclosing another person's biometric identifiers.<sup>71</sup>

There are three exceptions for when a governmental body may disclose a person's biometric information. These are: 1) when an individual provides consent to the disclosure; 2) a federal or state law, other than Chapter 552 of the Texas Government Code, requires or permits such disclosure; or 3) the disclosure is made by or to a law enforcement agency for a law enforcement purpose.<sup>72</sup>

If a governmental body collects an individual's biometric identifiers pursuant to the above exceptions, state law requires it to:

"store, transmit, and protect from disclosure the biometric identifier using reasonable care and in a manner that is the same as or more protective than the manner in which the governmental body stores, transmits, and protects its other confidential information."<sup>73</sup>

To further protect a person's identity, governmental bodies are exempted from disclosing the individual's biometric identifiers in response to a public information request under Chapter 552.<sup>74</sup>

### B. Private Entities

Texas law prohibits a person from "obtain[ing], possess[ing], transfer[ring], or us[ing] personal identifying information of another person without the other person's consent or effective consent and with intent to obtain a good, a service, insurance, an extension of credit, or any other thing of value in the other person's name."<sup>75</sup> State law also enumerates what constitutes effective consent,

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<sup>68</sup> Tex. Gov't Code § 560.001(1).

<sup>69</sup> Tex. Business & Commerce Code § 521.002(C).

<sup>70</sup> *Id.* at § 560.001(2) (referencing Texas Government Code, § 552.003 in defining "governmental body")

<sup>71</sup> *Id.* at § 560.002(1).

<sup>72</sup> *Id.* at § 560.002(1)(A)-(C).

<sup>73</sup> *Id.* at § 560.002(2).

<sup>74</sup> Tex. Gov't Code § 560.003.

<sup>75</sup> Tex. Gov't Code § 521.051(a). Excluded from this prohibition are financial institutions defined in 15 U.S.C. Section 6809 and covered entities set forth in Texas Insurance Code Section 601.001 or 602.001. Tex. Gov't Code § 521.051(c).

and when consent is not effective (i.e., under force, threat, fraud).<sup>76</sup> When disposing of records containing personal identifying information, including biometric identifiers, businesses are required to do so in a manner that makes the information unreadable or undecipherable.<sup>77</sup>

## 87th Legislature

### A. Biometric Identifiers

During the interim of the 86th Legislature, the Texas Cybersecurity Council and the Texas Privacy Protection Advisory Council made recommendations to improve cybersecurity standards and data management practices for state agencies and local governments.<sup>78</sup> During the regular session of the 87th Legislature, Senator Jane Nelson incorporated those recommendations into SB 475, which passed into law. The bill implemented a variety of key provisions to improve the State's cybersecurity. For purposes of this report, the relevant aspect of SB 475 was its prohibition on state agencies from acquiring, retaining, or disseminating data used to identify an individual or the individual's location without written or electronic consent.<sup>79</sup>

More specifically, *without the individual's written or electronic consent*, a state agency cannot:

(1) use [GPS] technology, individual contact tracing, or technology designed to obtain biometric identifiers<sup>80</sup> to acquire information that alone or in conjunction with other information identifies an individual or his/her location. . . ; (2) retain information with respect to an individual described by Subdivision (1). . . ; or (3) disseminate to a person the information described by Subdivision (1) with respect to an individual unless the state agency first obtains the individual's written or electronic consent.<sup>81</sup>

The prohibition applies to a state agency that is "a department, commission, board, office, council, authority, or other agency in the executive, legislative, or judicial branch of state government, including a university system or institution of higher education as defined by Section 61.003, Education Code, that is created by the constitution or a statute of this state."<sup>82</sup>

A person's consent is not required when the acquisition, retention, or dissemination is: 1) required or permitted by state law, other than the Texas public information statute; or 2) made by or to a law enforcement agency for a law enforcement purpose.<sup>83</sup>

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<sup>76</sup> See *Id.* at § 521.051(a-1).

<sup>77</sup> Tex. Business & Comm. Code § 72.004. Same entities exempted under Texas Government Code § 521.051 are also excluded under this section. Tex. Business & Comm. Code § 72.004(a).

<sup>78</sup> SB 475 HRO Bill Analysis

<sup>79</sup> SB 475 (87th R Leg. Session, Nelson), Enrolled Bill Summary,

<sup>80</sup> Biometric identifiers has the same meaning in Chapter 2062 as it currently exists in state law under Chapter 560 of the Texas Government Code. Tex. Gov't Code § 2062.001(1).

<sup>81</sup> Tex. Gov't Code § 2062.002(a)(1)-(3).

<sup>82</sup> Tex. Gov't Code § 2062.001(2).

<sup>83</sup> Tex. Gov't Code § 2062.002(b) (specifically excluding Texas Government Code Chapter 552 from consent exception).

If an individual does give written or electronic consent to a state agency to acquire, retain, and disseminate the individual's information, the agency must retain the consent in its records until the contract or agreement under which the information is acquired, retained, or disseminated expires.<sup>84</sup>

This part of SB 475 went into effect on September 1, 2021.<sup>85</sup>

## **B. Fraudulent/Spoofed Government Websites**

Legislation passed during the regular session of the 87th Legislature stemmed from a situation involving the Port of Corpus Christi Authority (Authority) and the Port of Corpus Christi LP.<sup>86</sup> In 2014, Kenneth Berry filed a certificate of formation with the Office of the Secretary of State (SOS) to form a limited partnership under the name “The Port of Corpus Christi, LP” (LP).<sup>87</sup> The SOS mistakenly allowed the name filing, but subsequently notified LP that the name “The Port of Corpus Christi falsely implies a governmental affiliation.”<sup>88</sup> The SOS then requested that LP amend its certificate of formation. LP did not comply with the request, and at the time, the SOS had no mechanism to remove the registration.<sup>89</sup> As such, the Authority sued the Corpus Christi LP for service marks and trade name infringement violations. The lack of recourse available to the SOS led to the passing of House Bill 1493.

HB 1493 authorizes a governmental unit to enjoin another person's use of an entity name that falsely implies governmental affiliation with the governmental unit.<sup>90</sup> The governmental unit is entitled to injunctive relief throughout the state.<sup>91</sup> The new law continues that if the court finds the person against whom the injunctive relief is sought willfully intended to imply governmental affiliation with the governmental unit, then the governmental unit may be awarded reasonable attorney's fees and court costs.<sup>92</sup>

HB 1493 also prohibits a filing entity or a foreign filing entity from using a name in Texas that falsely implies an affiliation with a governmental entity.<sup>93</sup> The bill then creates a process through which the SOS, on request by a governmental entity, may determine whether a filing entity or foreign filing entity has a name that violates this prohibition.<sup>94</sup> If the SOS finds that the filing entity violated the prohibition, then the violating party must cease transacting business or operating under that name in Texas and file with the SOS the applicable instrument to amend the entity's

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<sup>84</sup> Tex. Gov't Code § 2062.002(c).

<sup>85</sup> See Tex. Gov't Code §§ 2062.001-2062.003.

<sup>86</sup> House Comm on Judiciary and Civil Jurisprudence (3.24.21), Rep. Herrero testimony, 3.24.21; Senate Comm on State Affairs, Sen. Hinojosa testimony (4.6.21).

<sup>87</sup> Memorandum Opinion, *The Port of Corpus Christi, LP v. The Port of Corpus Christi Auth. of Nueces County*, (Court of Appeals, 13th Dist. of Tex., July 1, 2021), Case No. 13-19-00378-CV, at 2, <https://law.justia.com/cases/texas/thirteenth-court-of-appeals/2021/13-19-00378-cv.html>

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

<sup>90</sup> Civil Practice & Remedies Code § 150C.002(a).

<sup>91</sup> *Id.* at § 150C.002(b).

<sup>92</sup> *Id.* at § 150C.002(c).

<sup>93</sup> Tex. Busi. & Organizations Code § 5.064.

<sup>94</sup> HB 1493 Enrolled Bill Summary. See also Tex. Busi. & Organizations Code § 5.065.

name as shown in the Secretary's records.<sup>95</sup> The attorney general is authorized to bring an action for injunctive relief if the violating entity fails to take the corrective action.<sup>96</sup>

To date, pursuant to the bill's provisions, the SOS has not: 1) made any determinations or notified any filing entities that they are falsely implying an affiliation with a governmental entity; or 2) notified the Attorney General's office of any potential false implications.<sup>97</sup>

## **Interim Hearing**

On May 25, 2022, the Senate Committee on State Affairs held an interim hearing covering the charge of privacy and transparency provided by the Lieutenant Governor. Invited testimony included Texas Department of Information Resources, Deputy Chief Information Security Officer for Policy and Governance, Matthew Kelly and Texas Department of Public Safety, Crime Records Division, Chief Michelle Farris.<sup>98</sup>

### **A. Biometric Identifiers**

Chief Farris testified that DPS receives, handles and disseminates biometric identifiers when they are collected or submitted by local law enforcement offices. The biometric data includes fingerprints, palm prints, photos (also known as mugshots), and iris scans. The law enforcement agencies take a person's biometric identifiers during the arrest process and custodial events. DPS also receives biometric identifiers from statutorily authorized state agencies for individuals who are applying to receive a license or certificate from that agency.<sup>99</sup> DPS will transfer the biometric data to any law enforcement agency requesting the information as authorized under the disclosure statutes. DPS will also submit the biometric data to the FBI, and make it available to other law enforcement agencies across the nation.<sup>100</sup>

### **B. Website Impersonation/Spoofing**

Mr. Kelly testified that cyber criminals are known to impersonate legitimate government websites, also known as "spoofing", to disseminate false information, harvest credentials, collect personal information, and spread malware.<sup>101</sup> The false impersonation can lead to system or account compromise and potential financial loss. To support his testimony, Mr. Kelly referenced the alerts issued in 2020 by the Federal Bureau of Investigation and the Cybersecurity and Infrastructure Security Agency (CISA) regarding the potential for bad actors to try to impersonate election-related domains. He also stated that during the COVID-19 pandemic, the email security firm,

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<sup>95</sup> *Id.* See also Tex. Busi. & Organizations Code § 5.065.

<sup>96</sup> *Id.* See also Tex. Busi. & Organizations Code § 5.065.

<sup>97</sup> Communication with Secretary of State's Office, 12.20.22.

<sup>98</sup> Matthew Kelly, Deputy Chief Information Officer for Policy &, Tex. Dep't of Information Resources ("Kelly Testimony"), Testimony before the Texas Senate Committee on State Affairs (May 25, 2022) (written testimony, on file with committee); Chief Michelle Farris, Crime Records Division, Tex. Dep't of Public Safety ("Farris Testimony"), Testimony before the Texas Senate Committee on State Affairs (May 25, 2022) (written testimony, on file with committee).

<sup>99</sup> Farris Testimony, (Committee on State Affairs Hearing May 25, 2022).

<sup>100</sup> *Id.*

<sup>101</sup> Kelly Testimony, (Committee on State Affairs Hearing, May 25, 2022).

Proofpoint<sup>102</sup> found more than 600 suspicious domain registrations intending to imposter government websites offering free COVID-19 tests to Americans.<sup>103</sup> Mr. Kelly's examples and those incidents listed in the Background section of this charge are just some of the many instances of bad actors attempting to mislead, take advantage of, and defraud individuals and businesses.

DIR received grants in 2019 and 2021 to perform security assessments on all 254 counties. The assessment included a review of the processes and the security controls in place, including the government entities' websites. One of the results DIR found was that cyber criminals intended to set up phishing websites to mimic the counties' websites and use social engineering to trick Texans into handing over their personal information.<sup>104</sup>

To prevent bad actors from impersonating government websites, the federal government and the security industry recommend government entities use the top-level domain ".gov". This domain is only available to U.S. government entities including state agencies, cities, counties, towns, and independent school districts.<sup>105</sup> To use a .gov domain, the applicant must submit evidence to an official governmental entity that they are truly buying the domain name on behalf of a legitimate local or state governmental entity.<sup>106</sup> As a result, anyone visiting a .gov website knows they can trust the entity to be who it is purporting to be. Mr. Kelly further testified that, originally, the .gov domain was a \$400 annual cost, but currently, to encourage qualifying entities to use it, CISA is not charging any fees.

For the Texas.gov domain, DIR provides the management, registration, and authorization for its use and does not charge state agencies to register the Texas.gov domain. DIR also gives authorization and assists qualifying entities applying for a .gov domain in Texas.<sup>107</sup> Mr. Kelly concluded that if Texas government entities used the .gov domain for official websites, it could decrease the likelihood of Texans falling victim to online fraud while attempting to interact with their state or local governments.<sup>108</sup>

## Discussion

### A. Biometric Identifiers

As a law enforcement agency, DPS is exempted from the general prohibition of acquiring, retaining, and disseminating biometric data under SB 475. However, DPS has several measures in place to ensure that a person's data is not disclosed.

- i. *Biometric data submitted to the FBI.* The FBI has high standards in place when biometric data is transferred to it, and all vendors must satisfy these requirements when transferring

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<sup>102</sup> ProofPoint website: <https://www.proofpoint.com/us> (general information about the company, partners, resources, etc.)

<sup>103</sup> Kelly Testimony, (Committee on State Affairs Hearing, May 25, 2022).

<sup>104</sup> *Id.*

<sup>105</sup> *Id.*

<sup>106</sup> Kelly Testimony, (Committee on State Affairs Hearing, May 25, 2022).

<sup>107</sup> *Id.*

<sup>108</sup> Kelly Testimony, (Committee on State Affairs Hearing, May 25, 2022).

the data.<sup>109</sup> In addition, the FBI generally will only accept biometric data from the State's point of contact for such information. In Texas, DPS is that point of contact.<sup>110</sup> By having a single contact for the transfer of such highly sensitive information, this procedure helps protect a person's biometric identifiers from being used for unintended purposes.

- ii. *Biometric data submitted by authorized state agencies.* Before a state agency submits prints to DPS under Chapter 411 of the Texas Government Code, the individual must sign a required consent/authorization form notifying them of the submission and retention of the individual's biometric identifiers to DPS's clearinghouse.
- iii. *Audits.* DPS undergoes audits by the FBI and the State Auditor's Office.<sup>111</sup> Both of these audits help ensure that proper security measures are in place.

## **B. Fraudulent/Spoofed Websites**

Unfortunately, the incident involving Port of Corpus Christi Authority is not a singular event. In January 2020, DIR received approximately 50 reports of spoofing or impersonation submitted through the Statewide Portal for Enterprise Cybersecurity Threat, Risk, and Incident Management.<sup>112</sup> In May 2021, the Texas Workforce Commission issued a press release warning Texans about fake social media sites and scams using a spoof email address designed to mimic the TWC address in an attempt to get Texans' financial information.<sup>113</sup>

HB 1493 was an important step in the right direction to provide recourse against bad actors falsifying government websites. With the growth in cyber activity and crime, more measures must be taken to help prevent such fraudulent activity and raise awareness to government entities about resources available once they discover the cyber crime.

One of the readily available preventative measures is for a governmental entity to adopt the .gov domain as discussed by Mr. Kelly during the interim hearing. CISA is currently allowing qualifying government entities to register for a more secure, top-level .gov domain for no charge. On April 29, 2021, DIR distributed a notification about this through the Texas Information Sharing and Analysis Organization.<sup>114</sup> Governmental agencies should review the advantages/disadvantages of using a .gov domain and take advantage of using the domain if it would provide more security to its potential viewers and customers.

The Office of Chief Information Security Officer for DIR is also available as a resource to provide guidance and best practices for state and local entities' websites to help prevent cyber crime. DIR also offers various types of assessments for state and local government entities, such as industry-specific assessments, and a review of the internet and dark web for potential threats.<sup>115</sup>

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<sup>109</sup> Interview with Chief Farris, 12.20.22

<sup>110</sup> *Id.*

<sup>111</sup> *Id.*

<sup>112</sup> Interview with DIR, 12.20.22.

<sup>113</sup> Texas Workforce Commission, "TWC Warns of Imposter Sites, Phishing", (May 13, 2021), <https://www.twc.texas.gov/news/twc-warns-imposter-sites-phishing>

<sup>114</sup> Communication with DIR, 12.20.22.

<sup>115</sup> *Id.*



Other preventative measures include:<sup>116</sup>

- Buying similar domain names (for example, DIR could purchase dir.com, dir.us) and maintaining registration.
- Registering trademarks and copyrights.
- Educating customers and employees to verify domain names before sharing financial or personal information.

Finally, the Texas Workforce Commission provides scam prevention resources, which can be viewed at: <https://www.twc.texas.gov/avoiding-scams-and-schemes>

Local and state governmental bodies should review and take advantage of these preventative resources.

Once a governmental entity discovers their website has been falsely imitated, it should contact law enforcement and the relevant authorities. The governmental body can also contact DIR's Cyber Incident Response Team at [cirt@dir.texas.gov](mailto:cirt@dir.texas.gov).<sup>117</sup> The Response Team will assist with contacting the appropriate federal authorities and law enforcement to help remove the fraudulent website.<sup>118</sup>

DIR provided several websites that help entities with cybersecurity and that may be beneficial for governmental entities to use to report the cyber crime:<sup>119</sup>

- The Internet Corporation for Assigned Names and Numbers (ICANN)'s Domain Abuse Activity Reporting Project <https://www.icann.org/octo-ssr/daar>
- The Multi-State Information Sharing and Analysis Center (MS-ISAC) <https://www.cisecurity.org/isac/report-an-incident>
- Google De-indexing and content reporting: [https://support.google.com/legal/answer/3110420?visit\\_id=638071600939602174-971423363&rd=1](https://support.google.com/legal/answer/3110420?visit_id=638071600939602174-971423363&rd=1)

There are also guides available to the public on how to remove a false website.

Raising awareness and educating governmental entities as well as the general public with these resources would help prevent Texans from being misled, taken advantage, or defrauded when seeking assistance from a state website.

## **Recommendations**

### **A. Biometric Identifier Protection**

The State should continue to monitor the implementation of SB 475 by the various state agencies, and ensure they are taking the necessary steps to prevent unintended use of an individual's

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<sup>116</sup> *Id.*

<sup>117</sup> Communication with DIR.

<sup>118</sup> Communication with DIR.

<sup>119</sup> Communication with DIR.

biometric identifiers. It is also recommended that to the extent possible, state agencies should model the safety and security procedures used by DPS when they do acquire, retain, or disseminate a person's biometric data, including the notice provided to an individual to obtain his/her written or electronic consent. If not already occurring, an audit, whether by the State Auditor's Office or another recognizable entity, should be conducted periodically of the agencies subjected to SB 475 to ensure adequate cyber security and preventative measures are in place.

### **B. Fraudulent Government Websites**

Any state agency that is not already using a .gov domain should go ahead and register for one. Local and state government entities should be notified about the current no-charge registration for a .gov domain registration. Given the host of available resources to help prevent cyber crime, it is recommended to raise public awareness and education to government entities and the general public about these resources, how to prevent cyber crime, how to recognize cyber crime, and what do to when a government's website has been falsely imitated.

## **CHARGE NO. 3**

**Investment Practices:** *Study the investment practices of financial services firms and how those practices affect the state's public pensions. Make recommendations to ensure the state's public pension funds are not being invested to further political or social causes.*

### **Background**

#### **A. ESG and Asset Managers**

BlackRock alone manages almost \$150 billion of Texas retirees' money, including \$24 billion for state and local public pension plans.<sup>120</sup> The biggest three financial services firms, BlackRock, State Street, and Vanguard, control over \$20 trillion in assets. They are the biggest shareholders in 90% of public companies, and they cast 20-25% of all shareholder votes.

Together, these firms, and many others like them, have come to embrace business metrics and corporate policies that are frequently discussed under the banner of "ESG", which stands for Environmental, Social, and Governance standards. ESG investing, a strategy that focuses on the environmental or social impacts of a company's business and leadership, has proliferated among investment managers in the last several years.<sup>121</sup> The growing popularity and reach of ESG investing has begun to affect state pension funds, as major institutional investment managers incorporate it into all investment strategies, even those not marketed as ESG funds.

For instance, BlackRock, an external investment advisor for the Employees Retirement System of Texas,<sup>122</sup> has publicized that it has made a “firm-wide commitment to integrate ESG information into [its] investment processes,” to affect “all of BlackRock’s investment divisions and investment teams.”<sup>123</sup> In a January 2018 letter to CEOs, BlackRock chief executive Larry Fink opined that “[s]ociety is demanding that companies, both public and private, serve a social purpose.”<sup>124</sup> BlackRock has focused in particular on climate change. In January 2020, BlackRock joined Climate Action 100+, an investor-led initiative to act in concert to advocate that certain companies alter their business so that the U.S. may achieve net-zero emissions in accordance with the Paris Climate Agreement.<sup>125</sup> Also in 2020, BlackRock began “asking companies to publish SASB- and TCFD-aligned disclosures” including a “company’s plan for operating under a scenario where the Paris Agreement’s goal of limiting global warming to less than two degrees is fully realized,” threatening “to vote against management when companies have not made sufficient progress.”<sup>126</sup>

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<sup>120</sup> See BlackRocks's letter to the Senate Committee on State Affairs, September 9, 2022.

<sup>121</sup> See Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 Stan. L. Rev. 381, 387-88 (2020).

<sup>122</sup> See Employees Retirement System of Texas, *2021 Annual Comprehensive Financial Report*, at 13, <https://ers.texas.gov/About-ERS/reports-and-studies/reports-on-overall-ers-operations-and-financial-ma/2021-acfr>.

<sup>123</sup> BlackRock ESG Integration Statement (last revised Dec. 8, 2020) at 2, <https://www.blackrock.com/ch/individual/en/literature/publication/blk-esg-investment-statement-web.pdf>.

<sup>124</sup> Larry Fink, *Larry Fink's 2018 Letter to CEOs: A Sense of Purpose*, <https://www.blackrock.com/corporate/investor-relations/2018-larry-fink-ceo-letter>.

<sup>125</sup> Climate Action 100+, About, <https://www.climateaction100.org/about/>.

<sup>126</sup> BlackRock Global Executive Committee, *2020 Letters to Clients*, <https://www.blackrock.com/ca/investors/en/blackrock-client-letter>.

BlackRock has made good on this promise: As of September 2020, the firm had taken “voting action against 53 companies for insufficient progress on climate risk management” and “put 191 companies ‘on watch,’” with the expectation that going forward they take “significant steps to address the business risks they face from climate change.”<sup>127</sup> In April 2021, the Wall Street Journal reported that “[f]or the roughly 170 ESG shareholder proposals it voted on during the first half of the proxy year, BlackRock backed 91% of environmental proposals, 23% of social proposals and 26% of corporate-governance proposals.”<sup>128</sup>

BlackRock is not alone as it moves further into ESG investing: “BlackRock’s initiatives are part of a broader push by Wall Street—institutional investors, money managers, and banks—to wield influence through their investments.”<sup>129</sup> In November 2020, Cyrus Taraporevala, the CEO of State Street Global Advisors, another large asset manager, wrote a letter titled “Why We’re Joining Climate Action 100+.” He wrote that State Street’s reason for joining is “to work not only side-by-side on these issues, but hand-in-hand” and “to work closely with other asset managers and asset owners to scale our impact on climate change risks.”<sup>130</sup>

Why does this matter? With all of these firms combined as members of these climate initiatives, these organizations steer policy for literally trillions of dollars in assets. What’s more, membership requires commitments to take certain action. In joining NZAM, BlackRock committed to “[i]mplement a stewardship and engagement strategy, with a clear escalation and voting policy, that is consistent with our ambition for all assets under management to achieve net zero emissions by 2050 or sooner.”<sup>131</sup>

This is independent of any evaluation of profit or returns, but just an “off the top” commitment on a policy that has little to do with shareholder returns. These groups then establish “target” or “focus” companies to strong-arm into approved corporate behaviors. This affects the Texas economy more broadly. Many of the companies that are the “target” or “focus” of Climate Action 100+, and similar organizations, are energy or utility companies that are headquartered or have a major presence in our State. Companies like Exxon Mobile and ConocoPhillips employ many thousands of people.

Justifying their activism as a prudent business move to mitigate “investment exposure to climate risk,” Climate Action 100+ signatory investors and investor networks, overseen by a global Steering Committee, targeted a focus list of companies with an explicit agenda to implement corporate governance reform, pursue net-zero emissions strategies, and secure greater disclosure on company climate change risks.<sup>132</sup>

The Climate Action 100+ effort has attracted significant involvement from major investors across the globe. As of June 2021, the initiative boasts 570 investors responsible for over \$54 trillion in

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<sup>127</sup> BlackRock Investment Stewardship Annual Report at 11 (Sept. 2020),

<https://www.blackrock.com/corporate/literature/publication/blk-annual-stewardship-report-2020.pdf>.

<sup>128</sup> Dawn Lim, *BlackRock Takes Aggressive Posture on ESG Proxy Votes*, The Wall Street Journal (April 30, 2021), <https://www.wsj.com/articles/blackrock-takes-aggressive-posture-on-esg-proxy-votes-11619775002>.

<sup>129</sup> *Id.*

<sup>130</sup> See SSGA0013655, Cyrus Taraporevala, *Why We’re Joining Climate Action 100+* (November 2020).

<sup>131</sup> The Net Zero Asset Managers Commitment, [www.netzeroassetmanagers.org/commitment/](http://www.netzeroassetmanagers.org/commitment/) (emphasis added).

<sup>132</sup> Climate Action 100+, About, <https://www.climateaction100.org/about/>.

assets, allegedly representing “over 50 percent of all global assets under management.”<sup>133</sup> Prominent signatories include several of the largest U.S. asset managers, including BlackRock, State Street, and Northern Trust, as well as large U.S. and foreign pension funds, including CalPERS, CalSTRS, the New York State Common Retirement Fund, and Japan’s Government Pension Investment Fund, which is the largest in the world.<sup>134</sup>

Under Climate Action 100+’s oversight, investor signatories are “required to liaise with relevant network staff and/or lead investors to ensure engagement priorities and ambition are aligned with the goals of the initiative, as well as with the overall collaborative approach.”<sup>135</sup> Further, “[I]ead investors, and those engaging companies individually, must disclose through a bi-annual survey their engagement plans and priorities over the coming 12 months to ensure strong and concerted action.”<sup>136</sup> The initiative directs signatories to communicate “a central message” to their respective focus companies: “[I]naction by companies following engagement may result in investors taking further action.”<sup>137</sup>

Climate Action-aligned asset managers and public pensions are not just talking about taking action though, they are implementing it. One can see their behavior changing as a result of these memberships. Prior to 2020, “index fund managers rarely challenge[d] company management and ha[d] largely opposed climate change proposals. In 2018 and 2019, BlackRock and Vanguard only backed around 10% of climate-related shareholder resolutions.”<sup>138</sup> In the second half of 2020 though, according to BlackRock’s own documents, they supported 54% of all environmental and social proposals.<sup>139</sup>

Last year, hedge fund Engine No. 1 successfully placed three of its four climate-conscious candidates on Exxon’s board.<sup>140</sup> Given that the fund owns less than 0.02% of the Company’s voting shares,<sup>141</sup> it was essential that Engine No. 1 recruit other, larger investors to its cause. BlackRock, State Street, and Vanguard, who together own over 20% of Exxon,<sup>142</sup> each supported two or more of Engine No. 1’s candidates. CalPERS, CalSTRS, and the New York State Common

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<sup>133</sup> *Id.*

<sup>134</sup> *Climate Action 100+, Who’s Involved: Investors*, <https://www.climateaction100.org/whos-involved/investors/>.

<sup>135</sup> *Climate Action 100+, Approach: Engagement Process*, <https://www.climateaction100.org/approach/engagement-process/>.

<sup>136</sup> *Id.*

<sup>137</sup> *Id.*

<sup>138</sup> Sinead Cruise, Lawrence White, and Ross Kerber, *BlackRock vows tougher stance on climate after activist heat*, Reuters (Jan. 14, 2020), <https://www.reuters.com/article/us-blackrock-fink/blackrock-vows-tougher-stance-on-climate-after-activist-heat-idUSKBN1ZD12B>.

<sup>139</sup> *Our 2023 Global Outlook: A new investment playbook*, BlackRock, <https://www.blackrock.com/corporate/investor-relations/2021-blackrock-client-letter>.

<sup>140</sup> Jennifer Hiller & Svea Herbst-Bayliss, *Engine No. 1 Extends Gains with a Third Seat on Exxon Board*, REUTERS (June 2, 2021), <https://www.reuters.com/business/energy/engine-no-1-win-third-seat-exxon-board-based-preliminary-results-2021-06-02/>.

<sup>141</sup> Tim Quinson, *Exxon May Be Corporate America’s Canary in the Coal Mine*, BLOOMBERG (June 1, 2021), <https://www.bloomberg.com/news/articles/2021-06-01/exxon-mobil-may-be-big-oil-s-canary-in-the-coal-mine-green-insight>.

<sup>142</sup> At the time of the vote, BlackRock owned a 6.7% stake in Exxon, Vanguard owned 8.2%, and State Street owned 5.7%. See Svea Herbst-Bayliss, “BlackRock Backs 3 Dissidents to Shake Up Exxon Board,” REUTERS (May 25, 2021), <https://www.reuters.com/business/energy/exclusive-blackrock-backs-three-director-nominees-challenging-exxon-board-2021-05-25/>.

Retirement Fund—who, like BlackRock and State Street, are Climate Action 100+ signatories—publicly stated they would support Engine No. 1’s candidates before the vote took place.<sup>143</sup>

Among the most frustrating aspects of these firms' use of retiree money to achieve certain objectives is the fact that they seem to only prioritize these stated objections when others bear the consequences, but not when they themselves are on the hook. Just this year, Chevron had a shareholder proposal to perform a "racial equity audit" within the company. Although the Chevron board opposed the measure, State Street recommended a vote against management to support racial equity audits at Chevron. However, when there was an activist shareholder proposal to require racial equity audits at State Street itself, State Street's board voted against the proposal. This "good for thee but not for me" attitude is representative of the firm's behaviors, apparently designed to appease the most vociferous activists on twitter, so long as it only applies to others.

Similarly, BlackRock has been vocal about shutting down American coal plants rather than just divesting from them, even when they have decades of useful life left in the facilities. At the same time they are pushing to close reliable energy resources providing power to Americans, they have invested directly into much dirtier Chinese coal. BlackRock has over \$85 billion in coal assets around the world, but they would rather Texas move to less reliable resources.<sup>144</sup> This doublespeak doesn't necessarily implicate a breach of a fiduciary duty as it relates to Texas pensions, but it certainly further erodes these firms' credibility as they promise that Texans' own interests are their sole north star in investing Texas money. This was a persistent theme at the Committee's December hearing. Each witness attempted to explain away statement after statement from the companies themselves, explaining that the claims were limited to a technicality, or were merely puffery altogether.

The ESG trend threatens Texas pension beneficiaries, companies, and workers. To the extent ESG investing proves to be an unsound deviation from traditional investment principles, as many expect,<sup>145</sup> it jeopardizes the financial wellbeing of Texas retirees. Companies owned and staffed by Texans, especially those in the oil and gas industry, could also find themselves in the crosshairs of investors that prioritize environmental and social goals at the expense of their economic wellbeing. Finally, promoting ESG likely threatens workers by disproportionately pressuring labor-intensive industries and privileging automation.<sup>146</sup>

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<sup>143</sup> *Climate Action 100+ Investors Support New ExxonMobil Slate of Directors with Climate and Industry Experience*, Ceres (April 27, 2021), <https://www.ceres.org/news-center/press-releases/climate-action-100-investors-support-new-exxonmobil-slate-directors>. As of March 31, CalPERS owned around 0.23% of Exxon’s outstanding stock, while the New York State Common Retirement Fund and CalSTRS own about 0.18% each. See Nasdaq, XOM Institutional Holdings, <https://www.nasdaq.com/market-activity/stocks/xom/institutional-holdings>.

<sup>144</sup> Jasper Jolly, *BlackRock holds \$85bn in coal despite pledge to sell fossil fuel shares*, The Guardian (Jan. 13, 2021), <https://www.theguardian.com/business/2021/jan/13/blackrock-holds-85bn-in-coal-despite-pledge-to-sell-fossil-fuel-shares>.

<sup>145</sup> See, e.g., Bradford Cornell & Aswath Damodaran, *Valuing ESG: Doing Good or Sounding Good?*, SSRN (March 2020), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3557432](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3557432).

<sup>146</sup> *The ESG Bubble: Saving the Planet, Destroying Societies*, StoneX Flow Report (Feb. 2021), <https://www.politico.com/f/?id=00000177-adf8-d713-a777-edfe93f90000>.

## B. Proxy Voting

### 1. Proxy voting advisors

Proxy advisors are companies that advise large institutional investors on how to vote the shares they own. They purport to provide unbiased, expert advice on shareholder proposals to institutional investors. In America, two proxy advisory firms have taken over the market. Institutional Shareholder Services (ISS), a German company, and Glass Lewis, a Canadian company, control an estimated 97% of the market.<sup>147</sup> This results in the recommendations of these two firms alone, who have no financial interest in the impact these recommendations have on the companies, having an outsized influence over corporate practices and policies in the US. In the 2020 proxy season, 114 institutional investors with over \$5 trillion in assets under management voted in line with ISS and Glass Lewis guidance on 99.5% or more of proposals.<sup>148</sup>

These proxy advisory companies adopt "benchmark" policies that function as their default positions on classes of shareholder proposals. ISS told the committee at our December hearing that their benchmark recommendations are "neutral" and agnostic to policy. Even so, the benchmark voting policies for this year inform their institutional clients that they will "generally vote against" Climate Action 100+ Focus Group companies "in cases where ISS determines that the company is not taking the minimum steps needed to understand, assess, and mitigate risks related to climate change. . . ."<sup>149</sup> This is not a neutral policy, and if an institution like a public pension doesn't actively pursue and catch these votes to advise otherwise, their assets may be voted to advance these policies.

Rule changes at the federal level have led to further increases in the number of proposals that actually make it to a vote, putting institutions on the hot seat to evaluate more votes, only increasing the power of their advisors.<sup>150</sup> Proxy advisory firms do not have a financial stake in the companies for which they provide vote recommendations, they owe no fiduciary duties to the shareholders of those companies, and they are not subject to any regulation. With no requirement to demonstrate that their vote recommendations are tied to shareholder value, proxy advisory firm recommendations are often based on many factors that have no connection whatsoever to shareholder value.

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<sup>147</sup> James K. Glassman and Hester Peirce, *How Proxy Advisory Services Became So Powerful*, Mercatus Center (June 18, 2014), <https://www.mercatus.org/research/policy-briefs/how-proxy-advisory-services-became-so-powerful>.

<sup>148</sup> See Paul Rose, *Proxy Advisors and Market Power: A Review of Institutional Investor Robovoting*, MANHATTAN INSTITUTE (Apr. 2021), <https://media4.manhattan-institute.org/sites/default/files/proxy-advisors-market-power-review-investor-robovoting-PR.pdf> at 10.

<sup>149</sup> ISS United States Proxy Voting Guidelines Benchmark Policy Recommendations for 2022, p. 16-17.

<sup>150</sup> See SEC, *Shareholder Proposals: Staff Legal Bulletin 14L (CF)* (Nov. 3, 2021), <https://www.sec.gov/corpfin/staff-legal-bulletin-14l-shareholder-proposals>. See also *Shareholder Proposal Developments During the 2022 Proxy Season*, GIBSON DUNN (July 11, 2022), <https://www.gibsondunn.com/wp-content/uploads/2022/07/shareholder-proposal-developments-during-the-2022-proxy-season.pdf> at 2 (citing significant decrease in number of proposals excluded pursuant to a no-action request, with only 38% of no-action requests granted in 2022, compared to 71% in 2021 and 70% in 2020).



This perennial proxy advisory firm concern is only intensifying as companies are subject to an ever-increasing barrage of shareholder proposals on environmental, social, and political matters. When proxy voting decisions are influenced by factors unrelated to shareholder value – and when corporations are thus pressured to focus and spend resources on items unrelated to shareholder value – shareholder value will undoubtedly suffer over the long term. Many of the “best practices” espoused by proxy advisory firms are, at best, irrelevant to shareholder value. At worst, however, these “best practices” could negatively impact shareholder value and, by extension, hamper the U.S. economy by unduly constraining management. Relatedly, the shaming of public companies on the basis of issues unrelated to value has the potential to threaten capitalism over the long term.

## 2. ERS and TRS Votes

In late April of this year, the Texas Employee Retirement System voted in favor of several shareholder proposals for Bank of America, Citigroup, Goldman Sachs, and Wells Fargo to prohibit each bank from financing new exploration and development of fossil fuel supplies. These votes not only go against the interests of the fund membership, but against the economic interests of the state in general.

To get to the bottom of the issue, the committee called a hearing to talk to the state's two largest pension funds about their proxy voting process. ERS was roundly criticized by the committee for voting against the interests of Texas retirees and Texas businesses. TRS insisted they had a fool-proof system in place to avoid taking votes against its members interests.

Less than 48 hours later, on May 27th, TRS cast a vote in the Lowe's annual shareholder meeting in support of a proposal put forward by Educational Foundation of America (EFA), an organization whose mission is to “Advance[e] progressive change through the support of creative initiatives aimed at sustainability, justice and equity.” The proposal read in full: “RESOLVED: Shareholders call on Lowe’s to issue a public report by December 31, 2022, omitting confidential and inside information and at a reasonable cost, detailing all known and potential risks and costs to the company caused by the policies of State adopted or proposed policies severely restricting reproductive health care, and detailing any strategies beyond litigation and legal compliance that the Company can deploy to minimize or mitigate these risks.”

This proposal was specifically in response to the Texas Heartbeat Bill. EFA added that “[a]t its discretion, the board’s analysis may include any effects on hiring, retention and productivity of employees, and decisions regarding the closure or expansion of operations in states proposing or enacting restrictive laws and strategies such as any corporate public policy advocacy, related political contribution policies and human resource or educational strategies.”<sup>151</sup>

ISS says that this vote was recommended because it was a proposal to require additional reporting, and that almost all reporting proposals are supported because more information is generally good for shareholders. The flaw in this approach is that activist investors, who know

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<sup>151</sup> Brad Johnson, *Texas Teachers' Pension System Votes for Pro-Choice Group's Proposal at Shareholder Meeting*, *The Texan* (June 1, 2022), <https://thetexan.news/texas-teachers-pension-system-votes-for-pro-choice-groups-proposal-at-shareholder-meeting/>.



this default position, will couch any pet issue in terms of increased disclosure in order to harness the full sway of these proxy vote advisors influence.

### **The Committee's Work This Interim**

In May, the Committee met and talked with TRS and ERS about some of these issues and about the way the pension systems vote the shares they own on shareholder proposals and initiatives. At that hearing, the Committee authorized the chair to pursue the production of documents from these companies, and, if needed, to issue subpoenas to compel the production of documents and the appearance of witnesses.

In August, the Committee sent letters to BlackRock, State Street, Vanguard, and ISS asking for the production of certain categories of documents. Since that time, the committee has been in continuous communication with law firms for each of the companies and each company has continued to provide further production on a rolling basis. The Committee ultimately did issue a subpoena to BlackRock, requiring several classes of documents they had not yet produced. Since that time, the company has produced those documents, which the committee continues to review. On December 15, the Committee convened in Marshall, Texas to ask representatives from each of these firms about their ESG practices, and how commitments made to outside initiatives or organizations affect that firm's behavior as it relates to investing Texas retirees' funds.

### **Current Law on Investment of Retiree Assets**

The Texas Constitution requires that each public pension system “have a board of trustees to administer the system and to invest the funds of the system in such securities as the board may consider prudent investments.”<sup>152</sup> The Constitution further requires that when making investment decisions each board “exercise the judgment and care under the circumstances then prevailing that persons of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income therefrom as well as the probable safety of their capital.”<sup>153</sup> Trustees and investment managers are further instructed to “discharge [their] duties *solely in the interest of the participants and beneficiaries* . . . for the exclusive purposes of . . . providing benefits to participants and their beneficiaries; and . . . defraying reasonable expenses of administering the system.”<sup>154</sup>

The duty to invest “solely in the interests” of the members and beneficiaries incorporates trust law principles,<sup>155</sup> which prohibit a fiduciary from prioritizing third-party interests over the financial interests of a trust’s beneficiaries. “The trustee, in other words, is under a duty to the beneficiary in administering the trust not to be guided by the interest of any third person. Acting with mixed

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<sup>152</sup> Tex. Const. art. XVI, § 67.

<sup>153</sup> *Id.*

<sup>154</sup> Tex. Gov't Code § 802.203 (emphasis added).

<sup>155</sup> *Cf.* 29 U.S.C. § 1104 (analogous sole-interest ERISA standard); *Varity Corp. v. Howe*, 516 U.S. 489, 497 (1996) (noting that “the law of trusts will often inform . . . an effort to interpret ERISA’s fiduciary duties,” though it may not always be determinative).

motives triggers an irrebuttable presumption of wrongdoing, full stop.”<sup>156</sup> Thus, in managing the investments of a trust, “the trustee’s decisions ordinarily must not be motivated by a purpose of advancing or expressing the trustee’s personal views concerning social or political issues or causes,” except as expressly authorized by the terms of the trust or consent of the beneficiaries, or in some charitable contexts.<sup>157</sup> This is because a fiduciary has an “obligation to maximize the trust income by prudent investment.”<sup>158</sup>

Accordingly, Texas law may prohibit an investment manager from simultaneously pursuing ESG goals as well as financial considerations in managing Texas state pension funds. Doing so would promote the interests of third parties, instead of just those of the Texas state pension systems and its beneficiaries.<sup>159</sup>

## Recommendations

This conversation really began with SB 13, which requires the state to divest from companies that boycott oil and gas.<sup>160</sup> Since the passage of that law, the Texas Comptroller has offered a list of those companies, and BlackRock is on it.

In fact, just as the Legislature has required divestment from firms that boycott oil and gas, the Legislature has also required divestment in other scenarios over the last decade, including from companies that boycott Israel and from companies that withhold capital from firearms companies. Certain members of the Legislature have expressed an intent to pursue similar policies against companies with strong ties to China and Russia. Divestment is a valuable tool to ensure that Texan money works toward Texan values. That said, it is important that we also consider broader

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<sup>156</sup> Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 Stan. L. Rev. 381, 400-401 (2020) (citations and quotations omitted).

<sup>157</sup> Restatement (Third) of Trusts, § 90, cmt. c; *see also* Uniform Prudent Investor Act § 5 cmt. (1994) (“No form of so-called ‘social investing’ is consistent with the duty of loyalty if the investment activity entails sacrificing the interests of trust beneficiaries—for example, by accepting below-market returns—in favor of the interests of the persons supposedly benefitted by pursuing the particular social cause.”); Richard A. Posner & John H. Langbein, *Social Investing and the Law of Trusts*, 79 Mich. L. Rev. 72, 96 (1980) (“It remains to consider whether social investing is contrary to trust law and its statutory counterparts. We conclude that it is . . .”).

<sup>158</sup> *Blankenship v. Boyle*, 329 F. Supp. 1089, 1096-98 (D.D.C. 1971) (holding that trustees breached their fiduciary duty to coal miner beneficiaries to maximize income by holding an inordinate proportion of the trust’s assets in cash in non-interest-bearing checking accounts to benefit a union-controlled bank rather than investing the funds, even in government bonds, to generate returns for the beneficiaries); *see also* *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, 419-21 (2014) (holding that although they are not required to diversify, fiduciaries of ERISA-governed ESOP plan are not entitled to a generalized presumption of prudence; regardless of nonpecuniary goals, such as employee ownership of employer stock, ERISA’s reference to “benefits” refers to “*financial* benefits” (emphasis in original)); *Rippey v. Denver U.S. Nat. Bank*, 273 F. Supp. 718, 734 (D. Colo. 1967) (holding that trustee’s failure to seek the best price for stock in newspaper company, and decision instead to sell to permit non-beneficiary partial owner to maintain control, violated trustee’s duty to get the “best price obtainable” for trust beneficiaries).

<sup>159</sup> While ESG factors might lawfully be considered in determining whether a given investment strategy is the most profitable, they still likely cannot ultimately be permitted to prevail over financial considerations. *Cf. Withers v. Teachers’ Retirement System*, 447 F. Supp. 1248, 1256 (S.D.N.Y. 1978) (New York teachers’ pension fund invested in City bonds in part because City bankruptcy would have ultimately been detrimental to trust assets). In the same vein, Schanzenbach and Sitkoff distinguish between two types of ESG investing, inappropriate “collateral benefits ESG,” in which ESG factors are considered “for moral or ethical reasons or to benefit a third party,” and permissible “risk-return ESG,” in which ESG factors are considered “to improve risk-adjusted returns.” Schanzenbach & Sitkoff, *supra n. 1*, at 389-90.

<sup>160</sup> Tex. S.B. 13, 87th Leg., R.S. (2021).

mandates that don't impose a duty to withhold money, but instead instruct on how to invest money. The law on the fiduciary duty in Texas is clear, but it can always be clearer.

#### **A. Asset Managers and Advisors**

The state should consider requiring that all asset managers and advisors use only a fiduciary standard in investing public retiree money, so that maximizing returns for all is the universal standard. The public advisors and managers should consider only financial factors in deciding how to invest assets and how to vote shares, not factors that stem from commitments to other politically motivated groups. Where a public pension system hires managers or advisors who invest money by a standard other than the maximization of return, the state has an interest in creating accountability for pension board members to the retirees.

#### **B. Proxy Advisory Firms**

On proxy advisory firms, other options exist. Proxy advisory firms (or any other firms providing voting advice) should be required to demonstrate annually that their vote recommendations are in the best economic interest of shareholders, other than (1) with respect to company-sponsored proposals, such as the election of directors and the appointment of the independent auditor, or (2) where the proxy advisory firm recommended a vote consistent with the recommendation of a board of directors composed of a majority of independent directors.

Before adopting changes to their proxy voting policies, proxy advisory firms should be required to disclose the reasons for the proposed changes, including an analysis of how the proposed changes will enhance shareholder value, and provide a reasonable period during which all relevant constituencies could comment on the proposed changes. The final voting policies should only be issued following a reasonable time during which the proxy advisory firms must carefully consider the views expressed during the comment period. Comment letters should be required to be made publicly available on the websites of the proxy advisory firms.

## **APPENDIX**

Written testimony from the Committee's interim hearings is available upon request.