Ceres
Sustainability is the bottom line.

October 5, 2020

VIA ELECTRONIC FILING

Jeanne Klinefelter Wilson
Acting Assistant Secretary
Office of Regulations and Interpretations
Employee Benefits Security Administration, Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

Re: 1210-AB91, *Fiduciary Duties Regarding Proxy Voting and Shareholder Rights* proposed rule

Dear Assistant Secretary Wilson,

I am writing regarding the Department of Labor Employee Benefits Security Administration's proposed rule, *Fiduciary Duties Regarding Proxy Voting and Shareholder Rights*, Regulatory Identifier Number (RIN) number 1210-AB91.

Ceres is a nonprofit organization working with institutional investors and companies to build sustainability leadership and drive solutions throughout the economy. We support the Investor Network on Climate Risk and Sustainability, which consists of over 175 institutional investors managing more than $29 trillion in assets, who advance leading investment practices, corporate engagement strategies, and policy and regulatory solutions to address sustainability risks and opportunities. Ceres has worked closely with institutional investors since our founding in 1989, and with an expanding group of investors since the founding of our Investor Network 17 years ago.

The proposed rule would make an unwarranted change in the current understanding of fiduciary duty for those who manage ERISA covered pension plans. Fiduciary duty is widely understood to include active ownership, including informed proxy voting on shareholder proposals affecting companies owned by the plan. Shareholder proposals often address issues that can pose material financial risks to companies, such as climate change, human and worker rights and other environmental, social and governance (ESG) issues not being addressed by management. Shareholder proposals are a valuable tool for shareholder input into corporate policies and business strategies that affect shareholder value.

Members of our Investor Network have repeatedly emphasized the value of active ownership, including proxy voting on ESG and other issues, and corporate engagement, to protect and enhance the value of their investments. The proposed rule will severely harm fiduciaries by discouraging the use of these invaluable tools and by significantly raising the cost of voting, so I respectfully request that the Department extend the comment period from 30 to 120 days and schedule a public hearing to allow for additional input from investors affected by the proposed rule.

Because the proposed rule will harm the ability of fiduciaries to protect the interest of their beneficiaries, I urge the Department to withdraw it. If the Department instead chooses to issue the rule, I request that you substantially modify it in accordance with the facts, evidence and considerations below.

Responsibility to help corporate boards improve their governance is at the core of equity ownership in American business. Unlike the day to day decisions made by managers, many governance decisions -- including those concerning environmental and social issues -- play out over the medium and long term, and have far-reaching implications for the future health of the businesses they shape. These decisions guide businesses towards opportunities for growth and value creation, and serve as a critical means of managing risk. Proxy voting is an invaluable governance tool for investors. It enables owners to efficiently communicate with managers and boards about their core concerns about how ESG issues are managed.

The prescriptive nature of the proposed rule is particularly striking and inappropriate, suggesting that fund managers should not be trusted to use their judgement, and creating substantial burdens on the proxy voting they engage in. It seems contrary to the American system of a market economy for a government agency to selectively direct investor attention away from a specific set of issues. It is also inappropriate and counterproductive to impose new burdens on fiduciaries to determine which shareholder proposals meet the proposed criteria and should be voted on.

If case-by-case cost-benefit analysis is required as a precursor to shareholder engagement, it could also be required before adding to or trimming position sizes in a portfolio, neither of which would be practical or good policy. Asset managers and owners employ a wide range of approaches to maximize risk-adjusted returns, and asset owners should have the freedom to vote their proxies.

Many ESG issues pose financial risks in the short, medium and long term

Ceres' July 30, 2020 letter to the Department, in response to the *Financial Factors in Selecting Plan Investments* proposed rule, extensively documents on pages 2-8 how ESG issues pose financial risks to companies and investors in the short, medium and long term.[1] It discusses climate change, water and human rights issues, but many additional ESG issues pose risks that many investors analyze[2] and cast their proxy votes accordingly. The letter is attached as Appendix A.

[1] Mindy S. Lubber, Ceres, letter to the Department of Labor re: RIN 1210-AB95, *Financial Factors in Selecting Plan Investments* proposed rule (July 30, 2020) at 2-8, https://www.ceres.org/sites/default/files/Ceres%20comment%20letter%207-30-20.pdf.
[2] See *Id.* at 5.

Some ESG issues involve emerging risks, which are important for companies to consider, and are valid issues for proxy voting

While many ESG issues pose documented financial risks, investors also vote their proxies on shareholder resolutions about emerging issues, where it is difficult to determine the specific financial impacts on the company. The Department should not prevent fiduciaries from considering these risks in voting items on the proxy ballot.

A 2017 Ceres/US SIF/ICCR report, *The Business Case for the Current SEC Shareholder Proposal Process*, discusses many issues that could originally be classified as emerging risks, but have led to widely adopted practices that have improved corporate governance. They include independent directors on boards, majority voting of directors, proxy access, sustainability reporting, adoption of international human rights principles as part of corporate codes of conduct and supply chain policies, and sexual orientation nondiscrimination policies.[3]

The financial risks posed by hazardous chemicals and pesticides in products and supply chains provides another example of an emerging issue that is important for investors and companies to consider.[4] Over the last 10 years, investors have engaged over 100 companies on this issue, filing 165 chemical-related shareholder resolutions.[5] This is because of the slow pace of corporate responses to reduce this risk:

> Many chemicals of serious public health concern to the scientific community have not yet been restricted by regulatory bodies. . . . Despite the lack of restrictions on various chemicals of concern to public health experts and consumers, many companies exercise a compliance mentality when it comes to chemical management, i.e. if government regulations do not prohibit inclusion of a chemical in a product, then it is considered acceptable for inclusion. This often places companies at risk of market lockouts, consumer exodus and liability.[6]

Shareholder resolutions about these issues benefit company managers and directors by making them aware of emerging risks that could materially affect the company's performance over the short, medium or long term. Additionally, investors' resolutions, engagements, increasing regulation and other factors have improved companies' responses to these risks over time. A 2019 report found many examples of corporations reducing their chemical footprint, making significant improvements in their chemical management policies and practices, and disclosing this information publicly.[7]

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[3] Ceres, US SIF, ICCR, *The Business Case for the Current SEC Shareholder Proposal Process* (2017) at 5-6, https://www.ceres.org/resources/reports/business-case-current-sec-shareholder-proposal-process.

[4] See Investor Environmental Health Network: Impact web page, accessed September 15, 2020, https://iehn.org/membership/impact.

[5] *Id.* Examples of resolutions are available at https://iehn.org/resources/resolutions.

[6] Sanford Lewis, General Counsel, Investor Environmental Health Network, letter to Securities and Exchange Commission re: File Number S7-06-16 - Regulation S-K Concept Release on Business and Financial Disclosure Required by Regulation S-K (July 15, 2016) at 10, https://www.sec.gov/comments/s7-06-16/s70616-133.pdf.

[7] Chemical Footprint Project 2019 Annual Report Press Release, *Business leaders from diverse sectors reduce their chemical footprint*, November 14, 2019, https://www.chemicalfootprint.org/news/article/2019-chemical-footprint-project-press-release; See also Meg Wilcox, GreenBiz, *Chemical footprinting comes of age*, July 13, 2020,

Proxy voting is a critical tool for fiduciaries to address ESG risks and other types of risks

Investors need to have the freedom to use all the tools at their disposal in order to fulfill their fiduciary duties.[8] As the Department and others have recognized, this includes the duty of proxy voting.[9] Investors must have the right to use their fiduciary judgment to vote in favor or against proxy proposals without, for particular proxy votes, doing a cost benefit analysis or exhaustively documenting the basis for that vote.

The proposed rule ignores or downplays that institutional investors already approach their proxy voting methodically, including investigating factors that form the basis of proxy votes, seeking external advice on the merits of particular proposals, maintaining records of their activities, and integrating proxy voting into the investment research process. By focusing on justifying "particular" proxy votes, the Department is creating a burdensome new requirement that could dissuade fiduciaries from voting at all.

Institutional investors generally approach their proxy voting on ESG and other issues systematically, investigating factors that form the basis of proxy votes and maintaining detailed proxy voting policies which are publicly available.[10] The policies often cover voting on specified ESG issues, and they may also include provisions for voting on a case by case basis where appropriate.[11] Investors also maintain records on their proxy votes and make them publicly available,[12] and the SEC requires many asset managers to make public their proxy voting guidelines and proxy votes.[13]

Perhaps the most important point, the due diligence that informs proxy voting is an integral part of the investment research processes, for which there is no substitute. Information gleaned from research, such as companies that lag their peers in addressing ESG issues, feeds into proxy voting decisions.[14] Investors describe a circular process of ESG investment research: ESG

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https://www.greenbiz.com/article/chemical-footprinting-comes-age; Beverley Thorpe, GreenBiz, *Businesses are responding to demand for chemical transparency*, April 25, 2017, https://www.greenbiz.com/article/businesses-are-responding-demand-chemical-transparency.

[8] Ceres, *Addressing Climate as a Systemic Risk: A call to action for U.S. financial regulators* (June 2020) at 29, https://www.ceres.org/resources/reports/addressing-climate-systemic-risk.

[9] Keith Johnson and Cynthia William, *Fiduciary Duty Guidance for Proxy Voting Reform: SEC Roundtable Submission* (November 15, 2018) at 1-2, https://www.sec.gov/comments/4-725/4725-4650533-176476.pdf.

[10] See, for example, New York City Employees' Retirement System, New York City Police Pension Fund, New York City Fire Pension Plan, Board of Education Retirement System of the City of New York, *Corporate Governance Principles and Proxy Voting Guidelines* (February 2019) at 10-36, https://comptroller.nyc.gov/wp-content/uploads/documents/NYCRS-Corporate-Governance-Principles-and-Proxy-Voting-Guidelines_2019-Revised-February-2019.pdf.

[11] See, for example, *Id.* at 30-36.

[12] See, for example, the online records of proxy votes from the Connecticut Retirement Plans and Trust Funds, CalPERS and Vanguard.

[13] Securities and Exchange Commission, *Final Rule: Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies*, Release Nos. 33-8188, 34-47304, IC-25922; File No. S7-36-02, available at https://www.sec.gov/rules/final/33-8188.htm.

[14] See, for example, UN PRI, *A Practical Guide to Active Ownership in Listed Equity* (hereafter *Active Ownership in Listed Equity*) (2018) at 30, https://www.unpri.org/download?ac=4151. This report is based upon interviews with 41

research and due diligence are incorporated into investment decisions, which informs corporate engagements and dialogues (including which companies to engage with, and how to vote proxies), and information obtained from dialogues and proxy voting results feeds into portfolio construction decisions and additional ESG research used for investment, engagement and voting decisions.[15] Shareholder proposals and proxy voting are an important tool to move corporate boards and management to address ESG and other issues in cases where the company has not responded adequately to other forms of investor engagement.

Regarding the lack of substitutions for proxy voting, many public pension funds and other investors note that they are "universal owners", with significant investments that use passive index strategies; they either cannot readily sell their shares, or they do not consider it strategic to sell shares and lose their ability to help companies improve their policies, practices and profitability. For example, 2018 Congressional testimony from the New York City Comptroller's office discusses the absence of alternatives to active ownership:

> Because of our long-term investment horizon, and the fact that we allocate more than 80% of the funds' investments in U.S. public equity through passive index strategies, we cannot readily sell shares in a company when we have concerns about the company's performance, board composition and quality, management, executive compensation, workplace practices or management of risks, including those related to climate change.
>
> In these instances, the only way we can protect and create long-term shareowner value is to be an active owner of our portfolio companies by exercising our legal rights as shareowners. We (1) actively vote our proxies at each portfolio company, and (2) actively engage our portfolio companies, mainly through shareowner proposals and dialogue ensuing from those efforts, in order to promote sound corporate governance and responsible and sustainable business practices.[16]

ESG-related proxy votes enhance the value of companies

ESG proxy voting has been shown to improve company financial performance and value and to benefit company managers and directors by making them aware of ESG issues that can materially affect the company's performance.[17] A 2019 report, *The role of investors in supporting better corporate ESG performance*, provides evidence that investor efforts to engage companies on ESG-related risks and opportunities are associated with better shareholder returns.[18] It also

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asset owners and managers worldwide. *Active Ownership in Listed Equity* at 3. See also UN PRI, *A Practical Guide to ESG Integration for Equity Investing* (2016) at 12, https://www.unpri.org/download?ac=10.

[15] See *Active Ownership in Listed Equity* at 30.

[16] Statement of Michael Garland, Assistant Comptroller for Corporate Governance and Responsible Investment, Office of New York City Comptroller Scott Stringer, Senate Banking Committee hearing entitled "Proxy Process and Rules: Examining Current Practices and Potential Changes" (December 6, 2018) at 1-2, https://www.banking.senate.gov/download/garland-testimony-12618.

[17] Ceres, US SIF, Interfaith Center on Corporate Responsibility (ICCR), *The Business Case for the Current SEC Shareholder Proposal Process* (April 2017) at 3-4, 7-9, 12-13, https://www.ceres.org/resources/reports/business-case-current-sec-shareholder-proposal-process.

[18] Ceres, Environmental Defense Fund, and KKS Advisors, 2019. *The role of investors in supporting better corporate ESG performance: Influence strategies for sustainable and long-term value creation*. Meridian Institute. Washington, DC at 3, https://www.ceres.org/sites/default/files/reports/2019-04/Investor_Influence_report.pdf.

found that research supports that investor engagement efforts enhance company management of material ESG issues.[19]

There is extensive academic evidence that ESG-related proxy votes enhance the value of companies. A 2015 study found that adoption of CSR shareholder proposals "leads to positive announcement returns and superior accounting performance, implying that these proposals are value enhancing. …labor productivity and sales growth increase after the vote."[20] A similar study out of MIT of 4,624 shareholder initiatives found that companies that adopted CSR proposals saw a persistent share-price increase of between 2.1% and 2.5% when the decision was announced.[21] A Harvard Business School study of ESG engagements from 1999-2009 found that successful engagements (those where the proposal was adopted) led to excess returns of 4.4% over a 1 year period.[22]

It is impossible to reconcile these and many other studies with this statement in the proposed rule: "The Department's concerns about plans' voting costs sometimes exceeding attendant benefits has been amplified by the recent increase in the number of environmental and social shareholder proposals introduced. *It is likely that many of these proposals have little bearing on share value or other relation to plan interests.*" (emphasis added) The Department supports its statement that these proposals have little bearing on share value, in footnote 81 of the proposed rule, by a citation to one academic study and a report commissioned by an industry trade association.

I am concerned the Department has provided no evidence that it has considered research and data that supports the value of ESG related proxy voting. For example, the CalPERS Sustainable Investment Research Initiative Library, which is publicly available, is a searchable database of academic studies about the impact of sustainability factors on risk and return for long-term investors.[23] It contains 2,430 studies on environmental, social and governance factors in investing.

ESG shareholder resolutions and strong shareholder votes on them often enhance the value of other companies in the same industry as the recipient company, because resolutions and engagements result in improved corporate practices, which in turn has cascading impacts across the industry. Recent research out of MIT finds that when a Corporate Social Responsibility (CSR) initiative is adopted, it often results in increased social responsibility engagement by its competitors, magnifying the impact of a given initiative. Competitors may take these actions as a

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[19] *Id.* at 3-4.

[20] *Does Corporate Social Responsibility Lead to Superior Financial Performance? A Regression Discontinuity Approach*, Caroline Flammer, 19 Feb 2015, https://pubsonline.informs.org/doi/10.1287/mnsc.2014.2038.

[21] *Corporate Social Responsibility, Shareholder Value, and Competition*, 14 Aug 2020, Fernando Martins, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3651240.

[22] Elroy Dimsona, Oğuzhan Karakaşb, Xi Lic, *Active Ownership* (4 June 2013), https://www.hbs.edu/faculty/conferences/2013-sustainability-and-corporation/Documents/Active_Ownership_-_Dimson_Karakas_Li_v131_complete.pdf.

[23] CalPERS, *Sustainable Investment Research Initiative Library*, https://www.calpers.ca.gov/page/investments/sustainable-investments-program/esg-integration/siri-library, accessed September 14, 2020.

strategic response, or because they have many investors in common and anticipate similar shareholder actions in future shareholder meetings.[24]

Another example is the increase in corporations analyzing their sustainability risks and publicly reporting on them. Since 2009, 85 companies have begun issuing sustainability reports as a result of shareholder resolutions, but over 200 other companies in the S&P 500 have also adopted the practice.[25] Generally, shareholder resolutions serve as an important means of signaling to corporate management what is important to investors, and are closely watched by investors as indicators of management quality.

ESG-related proxy voting and systemic risks

The Department's proposal threatens to derail increasing investor efforts to address ESG issues, like climate change, that pose dangerous risks both to specific companies and to the U.S. and global economies. For climate change, institutional investors have extensively researched the financial risks and opportunities it poses to many sectors, and have created proxy voting policies that specify the types of climate-related resolutions they will vote for. Because climate is a systemic risk, investors have realized that the most efficient, logical method for them to approach climate risk is to focus on the industries facing the greatest risks. Part of that is done through proxy voting policies that specifically address climate change, and, in most cases, not separately analyzing the materiality of climate issues raised by particular resolutions.

A new report from the Commodity Futures Trading Commission's (CFTC) Climate-Related Market Risk Subcommittee discusses the systematic risks posed by climate change and notes that:

- "Climate change poses a major risk to the stability of the U.S. financial system and to its ability to sustain the American economy;" and
- "U.S. financial regulators must recognize that climate change poses serious emerging risks to the U.S. financial system, and they should move urgently and decisively to measure, understand, and address these risks;".[26]

The report notes that existing Department of Labor policies impede sustainable investment practices, and may make ERISA plans sponsors and managers "believe they could risk violating their fiduciary duties if they integrate sustainability factors into their investment approach."[27]

Ceres' report, *Addressing Climate as a Systemic Risk*, found that the wide-ranging physical impacts of climate change, "combined with expected transitions to a net-zero carbon economy and other socio-economic ripples, are likely to manifest in both cumulative and unexpected ways

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[24] *Corporate Social Responsibility, Shareholder Value, and Competition*, 14 Aug 2020, Fernando Martins, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3651240.

[25] Governance & Accountability Institute, Inc., *Flash Report: 86% of S&P 500 Index Companies Publish Sustainability / Responsibility Reports in 2018*. https://www.ga-institute.com/press-releases/article/flash-report-86-of-sp-500-indexR-companies-publish-sustainability-responsibility-reports-in-20.html.

[26] Climate-Related Market Risk Subcommittee (2020), *Managing Climate Risk in the U.S. Financial System*, Washington, D.C., U.S. Commodity Futures Trading Commission, Market Risk Advisory Committee at i, ii, https://www.cftc.gov/PressRoom/PressReleases/8234-20.

[27] *Id.* at 107-108.

and present clear systemic risks to U.S. financial markets -- and the broader economy. Left unmanaged, these risks could have significant, disruptive consequences on asset valuations, global financial markets and global economic stability."[28] The report recommends that the Department "should initiate an inter-agency process with the SEC to clarify the right of pension fund trustees and administrators to integrate ESG factors such as climate change into their investment decisions."[29]

Both reports suggest the Department should take a more active role, along with federal and state financial regulators, in supporting investor efforts to address ESG risks, rather than promulgating rules that deter investors from considering and taking action to address such issues. Considering the systemic risks that climate change and other ESG issues pose, I recommend the Department reconsider its views on fiduciary duties and ESG in the proposed rule.

In keeping with its previous guidance, the Department should expressly permit fiduciaries to consider whether benefits to the plan from the exercise of shareholder rights may be realized over relevant investment time frames, even if difficult to quantify.

The proposed rule is a significant departure from prior Department guidance, interpretations and practice on proxy voting issues. Therefore, while I believe the proposed rule should be withdrawn, should the Department issue the rule, it should amend proposed section (e)(2)(ii)(A), which requires the responsible plan fiduciary to "[a]ct solely in accordance with the economic interest of the plan and its participants and beneficiaries considering only factors that they prudently determine will affect the economic value of the plan's investment based on a determination of risk and return over an appropriate investment horizon consistent with the plan's investment objectives and the funding policy of the plan". The amendment should expressly permit such fiduciary to consider whether benefits to the plan from the exercise of shareholder rights may result in the short, medium and/or long-term, even if difficult to quantify. Such an amendment would be consistent with prior Department guidance, which appropriately recognized plans as long-term investors.

For example, Field Assistance Bulletin 2018-01 states, "there may be circumstances, for example involving significantly indexed portfolios and important corporate governance reform issues, or other environmental or social issues that present significant operational risks and costs to business, and that are clearly connected to *long-term value creation* for shareholders with respect to which reasonable expenditure of plan assets to more actively engage with company management may be a prudent approach to protecting the value of a plan's investment." (emphasis added). Interpretive Bulletin 2016-01 expresses concern that prior Department guidance was "out of step with important domestic and international trends in investment management and have the potential to dissuade ERISA fiduciaries from exercising shareholder rights, including the voting of proxies, in areas that are increasingly being recognized as important to *long-term shareholder value*." (emphasis added). The Bulletin also states, "the Department believes that [Interpretive Bulletin] 2008-2 may be read as discouraging fiduciaries from recognizing the *long-term financial benefits that, although difficult to quantify*, can result

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[28] Ceres, *Addressing Climate as a Systemic Risk: A call to action for U.S. financial regulators* (June 2020) at vi, https://www.ceres.org/resources/reports/addressing-climate-systemic-risk.
[29] *Id.* at 30.

from thoughtful shareholder engagement when voting proxies, establishing a proxy voting policy, or otherwise exercising rights as shareholders.” (emphasis added).

Finally, Interpretive Bulletin 2008-02 states, “[a]n investment policy that contemplates activities intended to monitor or influence the management of corporations in which the plan owns stock is consistent with a fiduciary's obligations under ERISA where the responsible fiduciary concludes that there is a reasonable expectation that such monitoring or communication with management, by the plan alone or together with other shareholders, will enhance the economic value of the plan's investment….Such a reasonable expectation may exist in various circumstances, for example, where plan investments in corporate stock are held as *long-term investments* or where a plan may not be able to easily dispose such an investment.” (emphasis added).

The proposed rule introduces needless complexity and confusion over what *costs* a fiduciary must consider before exercising shareholder rights on behalf of a plan.

The proposed rule introduces needless complexity and confusion over what *costs* a fiduciary must consider before exercising shareholder rights on behalf of a plan. Footnote 63 to the proposed rule’s preamble, for example, states, “[t]he direct and indirect costs incurred by the corporation related to delaying the shareholders' meeting, such as additional proxy solicitation, legal, and administrative costs, would be an economic detriment to the plan's holding.” Still further, the proposed rule suggests fiduciaries must consider the “opportunity costs” of the proxy voting or engagement. 85 Fed. Reg. at 55224 (“[t]he proposed provisions confirm that when making their voting decisions, fiduciaries must perform reasonable investigations, understanding that certain proposals may require a more detailed or particularized voting analysis. Information that will better enable fiduciaries to determine whether or how to vote proxies on particular matters includes the cost of voting, including opportunity costs.”).

Yet, it’s entirely unclear how fiduciaries can ascertain (with respect to the former) or quantify (with respect to the latter) such information. In either case, costs of the issue to shareholder value, and opportunity costs of proxy voting and engagement, are inherently difficult to assess and quantify. The proposed rule risks setting off a time-consuming goose chase, squandering any cost savings the proposed rule sought to advance. Plan fiduciaries do not need any additional procedural burdens that distract from their essential functions in advancing and protecting the financial interests of plan beneficiaries.

The Department rightfully acknowledged over many years that the exercise of shareholder rights typically does not result in plans incurring significant expenditures. *See, e.g.*, Field Assistance Bulletin 2018-01 and Interpretive Bulletin 2016-01. Also rightfully acknowledged in prior guidance is the fact that proxy voting and shareholder engagement may indeed be the *only* practical approach to increasing the value of the plan’s investment. *See* Interpretive Bulletin 2016-01 (“[t]he pervasiveness of US publicly-traded stock in ERISA plan investment portfolios, both direct holdings and through pooled investment funds, including index funds, is another factor that contributes to the importance of proxy voting and shareholder engagement practices….[i]f there is a problem identified with a portfolio company's management, selling the stock and finding a replacement investment may not be a prudent solution for a plan fiduciary.”).

The prevalence of index investing by plans militates against an unduly elastic concept of cost, as the Department here proposes. For these reasons, and in keeping with prior guidance, the Department should continue trusting its long relied-upon and protective standard, namely, by requiring the responsible plan fiduciary to consider the expected benefits and evaluate whether they outweigh any significant expenditure of plan assets in determining whether the activity is otherwise in the plan's economic interest.

The Department should continue permitting fiduciaries to consider whether the exercise of shareholder rights (*e.g.*, engagement), by the plan alone or together with other shareholders, will increase the value of the plan's investment after considering the costs.

Since at least 1994, and as recently reaffirmed in 2018, the Department has required fiduciaries to consider whether the plan's exercise of shareholder rights, either by itself *or together with the other shareholders*, is expected to have an effect on the value of the plan's investment that will outweigh its costs. *See, e.g.,* Interpretive Bulletin 94-2 and Field Assistance Bulletin 2018-01. I am concerned that the proposed rule could be construed as *not* permitting fiduciaries to consider the benefits of plans acting jointly with other shareholders when engaging an issuer. If anything, shareholders acting jointly would result in lower costs than if each shareholder acted on its own and would correspondingly increase the likelihood that such engagement will increase shareholder value. Moreover, it is common practice that shareholders jointly engage an issuer's board. I therefore request the Department to continue permitting fiduciaries to consider and determine whether the exercise of shareholder rights, including engagement, by the plan alone or together with other shareholders, will increase the value of the plan's investment after taking into account the costs.

The Climate Action 100+ initiative provides an example of shareholder collaboration to reduce financial risks facing investors and companies. This is an investor initiative -- over 500 institutional investors representing $47 trillion in assets under management -- to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change.[30] Investors leading the initiative organize engagements with 100 "systemically important emitters", accounting for two-thirds of annual global industrial GHG emissions, and more than 60 other companies with significant opportunities to drive the clean energy transition.[31]

The investor networks that coordinate the Climate Action 100+ initiative do not seek to provide voting recommendations or to facilitate block voting.[32] All investor signatories to the Climate Action 100+ initiative are responsible for their own voting decisions, including pre-declaration and vote solicitation.[33] But while the initiative is focused on investor-corporate engagement, some participating investors find that proxy voting related to climate change is very important to

[30] Climate Action 100+ homepage, http://www.climateaction100.org/, accessed September 16, 2020.
[31] *Id.*
[32] Climate Action 100+, Proxy Season 2020 web page, https://climateaction100.wpcomstaging.com/proxy-season-2020/, accessed September 16, 2020. See Climate Action 100+, About Us web page, https://climateaction100.wpcomstaging.com/about-us/, for a list of investor groups coordinating the initiative.
[33] Climate Action 100+, Proxy Season 2020 web page, https://climateaction100.wpcomstaging.com/proxy-season-2020/, accessed September 16, 2020.

improving corporate practices; key 2020 resolutions are posted on the initiative's website.[34] And the initiative has already seen significant progress from some focus companies:

- Climate change governance: 120 companies have now nominated a board member or board committee with explicit responsibility for oversight of the climate change;
- Alignment of value chain GHG emissions with the Paris Agreement Goals: 50 companies have indicated they will aim to achieve net-zero emissions by 2050 or sooner; and
- Task Force for Climate-related Financial Disclosures (TCFD) reporting: 59 companies have now formally supported the TCFD Recommendations via the official supporter statement.[35]

The Department should require fiduciaries, when voting proxies, to consider ESG issues that they determine will affect the value of their investments.

In the proposed rule's preamble, the Department noted that it "is now concerned that some fiduciaries and proxy advisory firms…may be acting in ways that unwittingly allow plan assets to be used to support or pursue proxy proposals for environmental, social, or public policy agendas that have no connection to increasing the value of investments used for the payment of benefits or plan administrative expenses, and in fact may have unnecessarily increased plan expenses." The fatal flaw in the Department's premise is the unwarranted assumption that environmental, social and governance (ESG) issues have no connection to increasing shareholder value. As I recently stressed in our comment letter on the Department's proposed rule, *Financial Factors in Selecting Plan Investments* (see attachment and hereby incorporated), "[t]he evidence is clear that ESG issues pose short, medium and long term financial impacts and risks that place them squarely within the category of material, financial risks that are factored into investment decisions." I therefore urge the Department to clarify that, for purposes of proposed section (e)(2)(ii)(A), the responsible plan fiduciary must consider any ESG issue that it determines is likely to affect the value of the plan's investment. We also urge the Department to clarify that, if the responsible plan fiduciary determines that an ESG issue will likely affect the value of the plan's investment in the short, medium and/or long term, the fiduciary will not be deemed to have violated proposed section (e)(2)(ii)(C), if it considers such ESG issue in deciding whether and when to exercise shareholder rights.

In closing, an analysis of responses to the *Financial Factors in Selecting Plan Investments* proposed rule found that 94% of investment-related firms and organizations opposed it, and singling out ESG for a heightened level of scrutiny and restriction "is inappropriate and unwarranted".[36] The *Fiduciary Duties Regarding Proxy Voting and Shareholder Rights* proposed rule is equally threatening and burdensome to fiduciaries and is unnecessary.

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[34] Climate Action 100+, Proxy Season 2020 web page, https://climateaction100.wpcomstaging.com/proxy-season-2020/, accessed September 16, 2020.

[35] Climate Action 100+ news release, *Climate Action 100+ calls for net-zero business strategies & sets out benchmark of largest corporate emitters*, September 14, 2020, https://climateaction100.wpcomstaging.com/news-and-events-2/, accessed September 16, 2020.

[36] Julie Gorte, Impax Asset Management, LLC, et. al., *Public Comments Overwhelmingly Oppose Proposed Rule Limiting the Use of ESG in ERISA Retirement Plans* (August 20, 2020) at 4, 8, https://www.ceres.org/news-center/press-releases/investor-organizations-and-financial-industry-firms-analysis-public.

I urge the Department to withdraw the proposed rule. If the Department instead chooses to issue the rule, I request that you schedule a public hearing on the proposed rulemaking and substantially modify the rule in accordance with the above facts, evidence and considerations.

Finally, I respectfully request that the Department extend the comment period from 30 to 120 days. An extension of the comment period will allow investors and other stakeholders enough time to provide thoughtful input into the proposal.

Sincerely,

Mindy S. Lubber
CEO and President
Ceres, Inc.

Counsel for Ceres
Jim Coburn

cc: Honorable Eugene Scalia, Secretary of Labor

Appendix A: Ceres' July 30, 2020 letter in response to the *Financial Factors in Selecting Plan Investments* proposed rule

Ceres
Sustainability is the bottom line.

July 30, 2020

VIA ELECTRONIC FILING

Office of Regulations and Interpretations
Employee Benefits Security Administration, Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

Re: RIN 1210-AB95, *Financial Factors in Selecting Plan Investments* proposed rule

Dear Assistant Secretary Wilson,

I am writing regarding the Department of Labor Employee Benefits Security Administration's proposed rule, *Financial Factors in Selecting Plan Investments*, Regulatory Identifier Number (RIN) number 1210-AB95.

Ceres is a nonprofit organization working with institutional investors and companies to build sustainability leadership and drive solutions throughout the economy. We support the Investor Network on Climate Risk and Sustainability, which consists of over 175 institutional investors managing more than $29 trillion in assets, who advance leading investment practices, corporate engagement strategies, and policy and regulatory solutions to address sustainability risks and opportunities. Ceres has worked closely with institutional investors since our founding in 1989, and with an expanding group of investors since the founding of our Investor Network 17 years ago.

I am concerned that the proposed rule would undermine fiduciaries from assessing and managing financially material environmental, social and governance (ESG) risks and opportunities in their investments. Members of our Investor Network have found that evaluating ESG issues provides a clearer picture of financial risks in their portfolios, enabling them to pursue a range of strategies to reduce those risks, including ESG integration in analysis and investment decisions, investing in companies with superior ESG performance, corporate engagement, and advocating for policy and regulatory solutions.

I urge the Department to withdraw, or in the alternative, substantially modify the proposed rule. Specifically, I call on The Department to: (1) Acknowledge that ESG issues may in fact pose material short, medium and long term financial impacts and risks; (2) Clarify that when ESG issues present material risks or opportunities, the fiduciary duties under the U.S. Employee Retirement Income Security Act of 1974, as amended (ERISA), would compel qualified investment professionals to treat such ESG issues as economic considerations; (3) Retain the "tie-breaker" test, which allows for ESG factors to be considered for *non-pecuniary* reasons; and (4) Rely upon its existing, protective framework in whether a ESG fund (pecuniary or non-pecuniary) may constitute a QDIA or component of a QDIA.

(1) ESG issues pose short, medium and long term financial impacts and risks

The proposed rule reflects an outdated and inaccurate view that ESG factors are non-financial and considering them can lower returns. The opposite is true. The evidence is clear that ESG issues pose short, medium and long term financial impacts and risks that place them squarely within the category of material, financial risks that are factored into investment decisions. These impacts range from significant to highly material, with certain ESG issues posing systemic risks. A prudent fiduciary should keep this evidence in mind as a part of their analysis. The Department should clearly acknowledge that ESG issues may in fact pose material short, medium and long term financial impacts and risks to companies and investments.

<u>Evidence is clear that ESG issues pose short, medium and long term financial impacts and risks to companies and financial markets</u>

Consequences of climate change provide clear evidence for the financial impacts and risks of ESG issues. For example, extreme weather events, made more frequent and severe by climate change, have led to mounting economic impacts. Since 1980, the U.S. has sustained more than 265 climate change-amplified extreme weather events with losses exceeding $1 billion, causing total costs exceeding $1.775 trillion. From 2015 to 2019, direct economic losses totaled more than $500 billion. These risks and losses are increasing as climate change and related physical impacts (e.g., sea level rise, extreme precipitation, stronger storms, flooding, heat waves, droughts) accelerate.[1]

Physical risks from rising global temperatures, which have increased 1.8° F since the mid-twentieth century, are the most immediate risk to the U.S. economy. Significant economic losses are projected for the years ahead. The U.S. Fourth National Climate Assessment suggests that unmitigated climate change could contract the U.S. economy by as much as 10% annually by the year 2100.[2] A 2019 analysis of 215 of the world's largest companies identified just under $1 trillion of potential risk to them from climate change – and noted that half of these losses are expected to materialize in the next five years.[3]

The longer it takes the U.S. to embrace the ongoing global transition to a net-zero carbon economy, the greater will be the future losses from the physical impacts of climate change. Doing so also neglects incredible opportunities for U.S. companies and employees to play a leading role in innovation and benefit by creating a wealth of opportunities for investors and spurring economic growth. Sectors that are critical to our economy – including energy, transportation, agriculture, banking and insurance – are particularly vulnerable to climate risks

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[1] Ceres, *Addressing Climate as a Systemic Risk: A call to action for U.S. financial regulators* (June 2020) at 1. Available at https://www.ceres.org/regulating-climate-financial-risk.
[2] Id. at vii.
[3] CDP, *World's biggest companies face $1 trillion in climate change risks*, June 4, 2019. Available at https://www.cdp.net/en/articles/media/worlds-biggest-companies-face-1-trillion-in-climate-change-risks.

and a poorly planned transition. These risks have already led to price volatility, competitiveness impacts, and asset losses.[4]

The transition away from fossil fuels could cause major disruptions and reduced valuations for the carbon-intensive assets that underpin much of today's U.S. economy - and in many cases it already has. Given the massive size of these industries – as much as a third of all equity and fixed income[5] assets are tied to carbon-related extraction and carbon-intensive industries such as utilities, transportation, chemicals, and industrial goods – these cumulative losses could have deep negative impacts on major financial institutions and other financial intermediaries holding these devalued assets. Some economists are concerned that if these changes strike lenders and investors quickly, the value of carbon-related assets could suddenly decline,[6] severely damaging asset values and bank balance sheets. Net exporters of fossil fuels, such as the U.S., are projected to fare poorly in this scenario.

Investments in long-lived carbon-intensive assets – such as oil and natural gas reserves – would be stranded if they are retired before the end of their productive lifespans, thereby creating financial losses.[7] A major drop in oil demand and oil prices, driven by a global low carbon transition, may cause the "carbon bubble", built on capital investments with a long lifespan, to burst. According to a 2018 study, the equivalent of between $1 trillion to $4 trillion could be removed from the global economy in fossil fuel assets alone in the next 15 years.[8] Another estimate that takes a broader view of stranded assets, assuming a later and more abrupt transition scenario, puts the value of potential losses as high as $20 trillion.[9]

Other ESG issues, such as water availability and quality, also pose profound financial risks. By 2030, global demand for water is expected to exceed supply by 40 percent, and 663 million —one in ten people — already live without access to safe water. Some regions, like East Asia, the Middle East and Central Africa, could see as much as a 6 percent contraction in GDP by 2050 due to water-related impacts on agriculture, health, and incomes. Water-related risks to business have material impacts on—or pose material risks to—investors, from underperformance of investments to increasing volatility and risks across entire asset classes.[10]

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[4] *Addressing Climate as a Systemic Risk* at 3.

[5] *Addressing Climate as a Systemic Risk* at 10, citing Tooze, Adam, *Why Central Banks Need to Step Up on Global Warming*, Foreign Policy, July 20, 2019 (https://foreignpolicy.com/2019/07/20/why-central-banks-need-to-step-up-on-global-warming/).

[6] *Addressing Climate as a Systemic Risk* at 10, citing Mercure, J.F., et al., "Macroeconomic Impact of Stranded Fossil Fuel Assets", Nature, June 4, 2018 (https://www.nature.com/articles/s41558-018-0182-1).

[7] *Addressing Climate as a Systemic Risk* at 10, citing "Oil and Gas Companies Approve $50 Billion of Major Projects that Undermine Climate Targets and Risk Shareholder Returns", Carbon Tracker Initiative, September 5, 2019 (https://carbontracker.org/oil-and-gas-companies-approve-50-billion-of-major-projects-that-undermine-climate-targets-and-risk-shareholder-returns/); Coffin, Mike and Grant, Andrew, "Breaking the Habit: Why None of the Large Oil Companies are 'Paris-Aligned', and What They Need to Do to Get There", Carbon Tracker Initiative, September 2019 (https://carbontracker.org/reports/breaking-the-habit/).

[8] *Addressing Climate as a Systemic Risk* at 10, citing Mercure, J.F., et al. "Macroeconomic Impact of Stranded Fossil Fuel Assets." Nature. June 4, 2018.

[9] *Addressing Climate as a Systemic Risk* at 10, citing Tooze, Adam. "Why Central Banks Need to Step Up on Global Warming." Foreign Policy. July 20, 2019

[10] Ceres, *Investor Water Toolkit: A Project of Ceres Investor Water Hub*, December 5, 2017 at 5 (https://www.ceres.org/resources/toolkits/investor-water-toolkit).

Water risks are driven by competition for water, inefficient water use, weak regulation, growing population, aging infrastructure, water contamination and climate change. The most significant risks are physical, regulatory and social, referring primarily to the social license to operate.[11]

One example of the manifestation of these risks to industry is growing water risks to agricultural commodity supply chains. Approximately 70 percent of freshwater is used to grow crops, feed livestock and process ingredients. By 2050, in order to meet the needs of a projected population of 9.7 billion, global water demands are expected to increase by 55 percent and food demands by 60 percent.[12]

Food and beverage companies are particularly vulnerable to these risks, including higher commodity price volatility and decreasing reliability of supplies. An MSCI analysis of food companies in its All Country World Index (ACWI) found that $459 billion in revenue may be at risk from lack of water available for irrigation or animal consumption, and $198 billion is at risk from changing precipitation patterns affecting current crop production areas.[13]

Beyond environmental issues, social issues can likewise pose material financial risks. There is substantial and growing evidence that human rights issues, which encompass workers' rights and diversity and inclusion strategies, pose financial impacts and risks to companies. Depending on the sector and a company's specific businesses, these impacts may materialize in different parts of global value chains (raw commodity sourcing, manufacturing and distribution, operations and retail, and product use), requiring investors to analyze these risks and engage with portfolio companies to understand them.

A 2018 report found that companies with poor human rights practices face risks including workplace injuries and illnesses, high turnover, and a greater chance of facing employee-related litigation. Companies also face lost opportunities if they are not able to take advantage of government incentives related to human rights, including procurement, export credit support, and trade incentives. Finally, human rights litigation is expanding and poses financial and reputational risks.[14]

In addition, studies of employment conditions found that firms that treat their workforce poorly suffer a host of negative consequences, including: weaker access to human capital; higher turnover (and associated financial costs of such instability); and decreased trust and innovation.[15] Similarly, McKinsey & Company has consistently found that companies with higher rates of racial and gender diversity outperform their peers, concluding most recently in 2020 that

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[11] *Investor Water Toolkit* at 8.
[12] *Investor Water Toolkit* at 13.
[13] MSCI, *Food Products Industry Report* (February 2017).
[14] Dr. Başak Bağlayan, Ingrid Landau, Marisa McVey & Kebene Wodajo, *Good Business: The Economic Case for Protecting Human Rights*, December 2018 at 18 (https://www.researchgate.net/publication/329828724_Good_Business_The_Economic_Case_for_Protecting_Human_Rights).
[15] Casey O'Connor, Sarah Labowitz, NYU Stern Center for Business and Human Rights, *Putting the "S" in ESG: Measuring Human Rights Performance for Investors*, March 2017 (https://www.stern.nyu.edu/experience-stern/global/putting-s-esg-measuring-human-rights-performance-investors).

companies in the top quartile for gender diversity on executive teams were 25 percent more likely to have above-average profitability than companies in the third quartile—up from 21 percent in 2017 and 15 percent in 2014.[16] In regard to global supply chains, a study on the impact of conflict with local communities shows that it leads to significant opportunity cost for companies in regards to future projects, project expansion, and sales.[17]

Investors have identified ESG issues that are material for every industry sector

Numerous firms, such as BlackRock, State Street Global Advisors, MSCI, and Sustainalytics, have analyzed the materiality of ESG issues to many industries, finding risks in every sector. For example, over a six year period the Sustainability Accounting Standards Board (SASB) analyzed the materiality of ESG issues in 77 industries. The investor consultation was extensive, with more than 2,800 individuals – affiliated with companies, and with investors representing $23.4 trillion in assets under management – participating in industry working groups.[18] The purpose was to develop standardized accounting metrics to better track and disclose ESG risks and improve analysis of these risks.

SASB found ESG issues that were likely to be material in each industry, with an average of six ESG topics for each industry.[19] In many cases, a particular ESG issue is material to many industries. For instance, SASB found climate change was likely to be material in 72 out of the 77 industries it covers, covering 93% of the U.S. equities by market capitalization.[20]

Universal asset owners and asset management firms have issued letters to CEOs, boards of their portfolio companies and governments calling on them to address climate change and other ESG issues – from their perspectives as investment fiduciaries for their clients and beneficiaries. The 2020 letter from Blackrock CEO Larry Fink to CEOs and boards of its portfolio companies noted climate change "has become a defining factor in companies' long-term prospects. … In the near future – and sooner than most anticipate – there will be a significant reallocation of capital."[21]

Some ESG issues pose systemic risks to financial markets

Some ESG issues pose systemic risks to financial markets. For instance, in addition to the climate change-related impacts and risks discussed above, climate change also poses systemic

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[16] Vivian Hunt, Sundiatu Dixon-Fyle, Sara Prince, Kevin Dolan, McKinsey & Company, *Diversity Wins: How Inclusion Matters*, May 2020 (https://www.mckinsey.com/featured-insights/diversity-and-inclusion/diversity-wins-how-inclusion-matters).
[17] *Putting the "S" in ESG: Measuring Human Rights Performance for Investors.*
[18] SASB, 2016 Consultation Guide, available at https://www.sasb.org/?s=consultation+guide (accessed July 6, 2020).
[19] SASB, *Response of the Sustainability Accounting Standards Board to the Public Consultation on the Revision of the Non-Financial Reporting Directive* at 5 (https://www.sasb.org/wp-content/uploads/2020/06/SASB.NFRDWhitepaper.FINAL-005.pdf).
[20] SASB, *Climate Risk Technical Bulletin*, October 2016 at 8-9 (https://www.sasb.org/knowledge-hub/climate-risk-technical-bulletin/).
[21] BlackRock, *A Fundamental Reshaping of Finance* (https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter); see also BlackRock's letter to clients, *Sustainability as BlackRock's New Standard for Investing* (https://www.blackrock.com/corporate/investor-relations/blackrock-client-letter).

risks to the stability of U.S. and global financial markets. Systemic risks are those that have the potential to destabilize capital markets and lead to serious negative consequences for financial institutions and the broader economy.[22]

Under this definition, climate change, like the current COVID-19 crisis, is indisputably a systemic risk. Its wide-ranging physical impacts, an accelerating transition to a low carbon economy, and other socio-economic ripples are likely to manifest in both cumulative and unexpected ways and present clear systemic risks to U.S. financial markets and the broader economy. If U.S. investors, companies and governments do not improve their management of these risks, they could have significant, disruptive consequences on asset valuations, global financial markets and global economic stability.[23] Many investors recognize this, which led 631 investors managing over US $37 trillion to sign the Global Investor Statement to Governments on Climate Change, which called on world governments to commit to improve climate-related financial reporting by companies and take other steps to reduce climate risks and expand related investment opportunities.[24]

In the long term, climate change poses debilitating systemic risks if not aggressively addressed. As the consulting firm Mercer recently reported:

> Investors such as pension funds, insurers, wealth managers, and endowments and foundations typically have multi decade time horizons, with portfolio exposure across the global economy. The implications of climate change are systemic and are already apparent. We have already experienced around 1°C of average warming above pre industrial levels, and extraordinary weather events with significant financial and human consequences are increasing in frequency. Humans have never lived in a world much warmer than today; yet the current trajectory of at least 3°C above the preindustrial average by 2100 could put us beyond the realm of human experience sometime in the next 30 years.[25]

Financial regulators and their associations globally have recognized systemic and material ESG risks in recent years and begun acting to address them. A 2019 survey of 33 central banks and supervisory authorities, collectively representing 77% of global GDP, found that 70% of them saw climate change "as a major threat to financial stability," and showed more than half are already acting to monitor and address climate risk.[26] IOSCO, the Central Banks and Supervisors Network for Greening the Financial System (NGFS), the Financial Stability Board and others have initiatives examining climate and/or sustainability risks, and governments in the UK,

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[22] *Addressing Climate as a Systemic Risk* at vi.
[23] *Addressing Climate as a Systemic Risk* at vi.
[24] Global Investor Statement to Governments on Climate Change (https://theinvestoragenda.org/focus-areas/policy-advocacy/).
[25] Mercer, *Investing in a Time of Climate Change: The Sequel 2019* (2019) at 6 (https://www.mercer.com/our-thinking/wealth/climate-change-the-sequel.html).
[26] *Addressing Climate as a Systemic Risk* at 2.

Australia, and Europe are taking action.[27] [28] [29] [30] The NGFS currently has 66 members, representing central banks and supervisors worldwide.[31]

The US financial regulatory community is also beginning to follow suit. In 2019, the Federal Reserve Banks of Dallas and St. Louis have examined the risks of losses in their regions from climate change. The San Francisco Federal Reserve Bank has written about climate risks which are "relevant considerations for the Federal Reserve in fulfilling its mandate for macroeconomic and financial stability." The Commodity Futures Trading Commission created a Climate-Related Market Risk Subcommittee to provide a report identifying and examining climate related financial and market risks throughout the U.S. economy. SEC Chairman Jay Clayton has spoken about the importance of human capital management and other sustainability risks, and the Commission has published multiple guidance documents and issued statements about the importance of COVID-19 related risks assessment and disclosure by issuers.[32]

Ceres' report, *Addressing Climate as a Systemic Risk: A call to action for U.S. financial regulators,* identifies over 50 specific recommendations for actions that federal and state financial regulators could take to address climate risks. Regarding the Department of Labor, the report encourages the Department to collaborate with the Securities and Exchange Commission:

> Supporting the ability of investors to engage on climate risks with their portfolio companies in an unimpeded manner would align with the SEC's mission to foster "fair, orderly and efficient markets." In the same vein, the Department of Labor should initiate an inter-agency process with the SEC to clarify the right of pension fund trustees and

[27] The Bank of England has announced plans for mandatory stress tests of the resilience of major U.K. banks and insurers on a range of climate scenarios. "Bank of England Consults on its Proposals for Stress Testing the Financial Stability Implications of Climate Change." Bank of England. December 18, 2019 (https://www.bankofengland.co.uk/news/2019/december/boe-consults-on-proposals-for-stress-testing-the-financial-stability-implications-of-climate-change); "Discussion Paper: The 2021 Biennial Exploratory Scenario on the Financial Risks from Climate Change", Bank of England, December 2019 (https://www.bankofengland.co.uk/paper/2019/biennial-exploratory-scenario-climate-change-discussion-paper).

[28] The Australian Prudential Regulation Authority plans to introduce mandatory stress tests of the country's banks, insurers and the pension fund industry to better understand climate impacts on the Australian economy. Summerhayes, Geoff. "Understanding and Managing the Financial Risks of Climate Change." Australian Prudential Regulation Authority. February 24, 2020, https://www.apra.gov.au/understanding-and-managing-financial-risks-of-climate-change.

[29] In 2019, the European Securities and Markets Authority issued technical advice outlining how fund managers should disclose how they integrate ESG risks in investment decisions, as well as their methodologies for measuring the ESG impacts of investments and products. "ESMA's Technical Advice to the European Commission on Integrating Sustainability Risks and Factors in the UCITS Directive and AIFMD." European Securities and Markets Authority, April 30, 2019, https://www.esma.europa.eu/sites/default/files/library/esma34-45-688_final_report_on_integrating_sustainability_risks_and_factors_in_the_ucits_directive_and_the_aifmd.pdf.

[30] In February 2020, the U.K. government released a proposal that would require pension funds to disclose how they integrate climate change across their governance, strategies and risk management. "Pension Schemes Bill [HL]: Running List of Amendments in Grand Committee." United Kingdom Parliament, February 13, 2020, https://services.parliament.uk/Bills/2019-21/pensionschemes/documents.html.

[31] https://www.ngfs.net/en/about-us/membership.

[32] See SEC Coronavirus (COVID-19) Response, Guidance and Targeted Regulatory Assistance and Relief, available at https://www.sec.gov/sec-coronavirus-covid-19-response.

administrators to integrate ESG factors such as climate change into their investment decisions.[33]

The proposed rule, by contrast, would harm the abilities of trustees and administrators to integrate ESG factors into their investment decisions, and it is contrary to the critical trend of regulators analyzing and helping market participants address ESG risks.

Finally, it is worth emphasizing how climate risks are particularly threatening to beneficiaries, industry sectors, and the U.S. economy. Climate change presents known, probable, and material risks to asset valuations across sectors and geographies. Coastal storm damage and the revaluation of fossil fuel companies are early examples of these impacts, and will prove small relative to future losses.

Regarding effects on the U.S. economy, as the US government continues to lag the rest of the developed world in embracing the transition to renewable energy, we are falling behind in the race to develop new technologies, skillsets and infrastructure that will prove critical to economic competitiveness and growth in years to come. This will come at a cost not only to investors in U.S. equities, but to our workforce, who will not have access to jobs in these growth industries.

Retirement savers generally own a broad diversified portfolio and are long term investors. While short term investors may profit by investing in companies that degrade the environment, such investments present risks not only in and of themselves, but over the course of time to a wide array of companies and sectors future retirees are also invested in. The interests of participants and beneficiaries are clearly served by maximizing the financial value of their retirement savings and mitigating material financial risks, but they are also served by protecting the world they live in so that they are able to enjoy their retirement free from the catastrophic effects of climate change.

(2) The Department needs to clarify that, when ESG issues present material risks or opportunities, ERISA's fiduciary duties would compel qualified investment professionals to consider them.

The Department needs to more clearly state, especially in the actual final regulation (should the Department move forward with this proposed rule), that when ESG issues present material risks or opportunities, ERISA's fiduciary duties would compel qualified investment professionals to treat such ESG issues as economic considerations under generally accepted investment theories.

<u>ESG investments, on average, provide comparable or superior returns to non-ESG investments</u>

The largest meta-study to date on the relation between ESG criteria and corporate financial performance (CFP) examined over 2,200 empirical and review studies. It found that the business

[33] *Addressing Climate as a Systemic Risk* at 30.

case for ESG investing is "empirically very well-founded" (investing in ESG "pays financially"), with "approximately 90% of studies find a nonnegative ESG–CFP relation."[34]

The study found that the positive ESG impact on corporate financial performance is stable over time.[35] Finally, it found that "ESG outperformance opportunities exist in many areas of the market", in particular North America, emerging markets, and non-equity asset classes.[36] Recent studies by S&P,[37] Morningstar,[38] and BlackRock[39] provide further evidence of this ESG outperformance.

U.S. investors are already considering ESG in engagement and investment decisions

It is currently a common, mainstream practice for U.S. institutional investors to consider ESG (or "sustainability") factors in their corporate engagement practices and engagement and investment decisions. The 175 institutional investors in the Ceres Investor Network, managing more than $29 trillion in assets, pursue this practice. In the U.S., sustainable investing's growth rate surpassed 38 percent from 2016 to 2018. According to US SIF, "more than one out of every four dollars under professional management in the United States today—26% of the $46.6 trillion in total assets under management tracked by Cerulli Associates—is involved in sustainable investing."[40]

The UN Principles for Responsible Investment Initiative (PRI) has over 3,000 signatories globally; 96% of their asset owner signatories have a mission, strategy or investment policy referencing responsible investment (i.e., investment that considers ESG factors) that covers the majority of their assets under management.[41] Eighty-nine percent of global institutional investors say they will request sustainability (ESG) information directly from portfolio companies, and 50% report they are "very likely" to sponsor or co-sponsor a shareholder proposal related to sustainability issues.[42] A July 2020 Government Accountability Office (GAO) report noted how important ESG disclosure is to U.S institutional investors: "Most institutional investors GAO interviewed (12 of 14) said they seek information on environmental,

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[34] Friede, Gunnar and Busch, Timo and Bassen, Alexander, *ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies,* Journal of Sustainable Finance & Investment, Volume 5, Issue 4 (October 2015) at 210, 212, 217 (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2699610).
[35] *ESG and Financial Performance: Aggregated Evidence* at 212.
[36] *ESG and Financial Performance: Aggregated Evidence* at 226.
[37] S&P Global Market Intelligence, *Major ESG investment funds outperforming S&P 500 during COVID-19*, April 13, 2020, https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/major-esg-investment-funds-outperforming-s-p-500-during-covid-19-57965103.
[38] Brendan Coffey, Forbes, *ESG Stocks Are Beating The S&P By 45% This Year*, November 12, 2019, https://www.forbes.com/sites/brendancoffey/2019/11/12/esg-stocks-are-having-a-fantastic-year/#6a8281182fbb.
[39] Hugh Leask, Hedgeweek, *New BlackRock research points to ESG resilience during coronavirus downturn*, May 15, 2020, https://www.hedgeweek.com/2020/05/19/285741/new-blackrock-research-points-esg-resilience-during-coronavirus-downturn.
[40] US SIF, *Sustainable Investing Basics*, https://www.ussif.org/sribasics (accessed July 6, 2020).
[41] https://www.unpri.org/pri/about-the-pri; https://www.unpri.org/annual-report-2019/2018/19-in-numbers.
[42] PwC. (2014). *Sustainability goes mainstream: Insights into investor views*. https://www.pwc.com/us/en/pwc-investor-resource-institute/publications/assets/pwc-sustainability-goes-mainstream-investor-views.pdf.

social, and governance (ESG) issues to better understand risks that could affect company financial performance over time. These investors added that they use ESG disclosures to monitor companies' management of ESG risks, inform their vote at shareholder meetings, or make stock purchasing decisions."[43]

CalPERS, the largest U.S. public pension fund, researches how ESG topics may affect their investments; integrates ESG considerations into investment decision-making; and engages with companies and managers to understand, mitigate, and/or manage ESG risks and opportunities.[44] BlackRock, the world's largest asset manager, has stated, "Environmental, social, and governance issues are integral to our investment stewardship activities, as the majority of our clients are saving for long-term goals. . . . Our risk analysis extends across all sectors and geographies, helping us identify companies lagging behind peers on ESG issues."[45]

The New York City Comptroller and three retirement systems have asked companies that have issued statements on racial equality, diversity or inclusion to disclose specific diversity information, to allow investors to evaluate companies' abilities "to hire, retain, and promote employees of color and women." The investors noted that research suggests "that companies in the top quartile for gender and ethnic/cultural diversity on executive teams have stronger financial performance."[46]

Additionally, BlackRock has noted that capital is already being allocated towards reducing sustainability risks, and that this trend is accelerating. The firm argued, "markets are a long way from fully pricing in the far-reaching consequences of changing attitudes toward sustainability: the impact will be more pronounced on some assets than others, and some assets will likely disappear altogether as sustainable preferences are embedded into market pricing."[47]

Regarding examples of how investors consider ESG in engagement and investment decisions, consider water. Ceres has worked with investors to develop tools for them to better understand water risks, and factor these risks into their investment decisions. I encourage the Department to

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[43] GAO, *Public Companies: Disclosure of Environmental, Social, and Governance Factors and Options to Enhance Them* (July 2020) at Highlights, 9-11,(https://www.gao.gov/products/gao-20-530.

[44] CalPERS, About the Sustainable Investments Program (https://www.calpers.ca.gov/page/investments/sustainable-investments-program/about-the-program), accessed July 5, 2020.

[45] BlackRock, Exploring ESG: A Practitioner's Perspective (June 2016) at 2, https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-exploring-esg-a-practitioners-perspective-june-2016.pdf.

[46] New York City Comptroller press release, *Comptroller Stringer and Three New York City Retirement Systems Call on 67 S&P 100 Companies Who Issued Supportive Statements on Racial Equality to Publicly Disclose the Composition of their Workforce by Race, Ethnicity and Gender* (July 1, 2020), https://comptroller.nyc.gov/newsroom/comptroller-stringer-and-three-new-york-city-retirement-systems-call-on-67-sp-100-companies-who-issued-supportive-statements-on-racial-equality-to-publicly-disclose-the-composition-of-their-workforce/.

[47] Black Rock Investment Institute, *Sustainability: The tectonic shift transforming investing – A framework for incorporating sustainable investing in portfolio construction* (February 2020) at 3, https://www.blackrock.com/us/individual/insights/blackrock-investment-institute/sustainability-in-portfolio-construction.

examine Ceres' Investor Water Hub case studies to understand better how investors are studying and addressing ESG risks, and consider how the proposed rule would hinder that work.[48]

The financial effects of ESG issues could manifest in the short, medium and long term

A recent MSCI research report demonstrates how different ESG issues affect financial performance over short, medium and long term time horizons. The firm analyzed an average of 1,600 companies, constituents of the MSCI World Index, over the time period of 2006 to 2019.[49] It analyzed three economic transmission channels from ESG characteristics to financial risk and performance—cash-flow, idiosyncratic risk, and valuation—using MSCI's ESG ratings.[50]

Specifically, MSCI's paper used its ESG pillar scores and their underlying Key Issues scores, which underpin the firm's ESG Ratings.[51] It found that different ESG indicators affected financial variables over different time horizons, [52] providing powerful evidence that appropriate investment horizons should incorporate ESG considerations over short, medium and long term time periods:

> "Governance pillar scores proved to be far more significant than Environmental and Social pillars over a relatively short period (one year) in terms of their impact on profitability, idiosyncratic risk and systematic risk, as they were most directly linked to short-term events and incident risks.
>
> "By contrast, Environmental and Social indicators were more significant over longer periods, as reflected in stock-price performance over the study period (2006-2019).
>
> "For example, carbon emissions and labor management showed no or minimal significance on profitability, idiosyncratic risk and systematic risk in the short term. However, it demonstrated the largest long-term performance impact of all 11 ESG Key Issues."[53]

Investors have an affirmative duty to consider ESG factors that are material to investment performance in investment decisions

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[48] Case studies include, for example, Lessons from Breckinridge Capital Advisors: Methods for Integrating Water Risk into Corporate and Municipal Bond Analysis; Scientifically Assessing the Water Performance of Investments with PGGM: A Pension Fund's Mission to Quantify Sustainability and Positive Water Impacts; Lessons for Investors from a Drought Stress-Testing Tool: Methods and Data Insights From a Drought Stress-Testing Tool; and Water Risk Footprinting of a Passive Portfolio with Florida SBA: Insights and Benefits of Water Footprinting And the Methods Applied; available at Ceres, *Investor Water Toolkit*, Case Studies, https://www.ceres.org/resources/toolkits/investor-water-toolkit/details#case-studies.
[49] MSCI, Guido Giese, Zoltan Nagy, Linda-Eling Lee, *Deconstructing ESG Ratings Performance: Risk and Return for E, S and G by Time Horizon, Sector and Weighting* (June 2020) at 9, https://www.msci.com/esg/deconstructing-esg-performance.
[50] *Deconstructing ESG Ratings Performance* at 7, 9.
[51] *Deconstructing ESG Ratings Performance* at 5.
[52] *Deconstructing ESG Ratings Performance* at 42.
[53] *Deconstructing ESG Ratings Performance* at 3.

Given that the materiality of ESG impacts and risks has now been extensively documented, and because such ESG-informed investments, on average, provide comparable or superior returns to non-ESG investments, investors have an affirmative duty to consider relevant, pecuniary-based ESG factors, especially where they could be material, in investment decisions.

The United Nations' Environment Programme and Principles for Responsible Investment conducted a global four-year study that addressed the question, "Is fiduciary duty a legitimate barrier to ESG integration by investors?" Their 2019 report produced extensive evidence showing the importance of incorporating ESG standards into regulatory concepts of fiduciary duty.[54] The report affirmed that most markets around the world have seen progress in incorporating ESG issues into expectations around investors' fiduciary duty – including in Canada, China, the EU, and the UK – with the notable exception of the U.S. markets.[55]

The report concludes that the fiduciary duties of loyalty and prudence require the incorporation of ESG issues into the investment process in the U.S. and other common law jurisdictions.[56] That includes requirements to incorporate ESG issues into investment analysis and decision-making, consistent with investors' investment time horizons; encourage high standards of ESG performance in the companies or other entities in which they invest; understand and incorporate beneficiaries' and savers' sustainability-related preferences; and report on how they have implemented these commitments.

The report argues there are three main reasons for this: that ESG incorporation is an investment norm, ESG issues are financially material, and policy and regulatory frameworks are changing to require ESG incorporation. Regarding those frameworks, the report notes that globally, there are over 730 hard and soft-law policy revisions, across some 500 policy instruments, that support, encourage or require investors to consider long-term value drivers, including ESG issues.[57] As many of our Investor Network members are invested in companies around the globe, they are already analyzing ESG risks that are disclosed under those policies.

Mercer has compiled evidence that considering climate risks is aligned with fiduciary duty, noting that "financial regulators are increasingly formalizing the expectation that investors should consider the materiality of these risks and manage them accordingly as part of their fiduciary duties — particularly for pension funds."[58] A Mercer report argues that two elements support this fiduciary duty alignment: the financial materiality of transition and physical damages risks and opportunities, and the growing legal and regulatory consensus that material climate-related factors must be considered and managed by fiduciaries.[59] Mercer noted that the

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[54] Elliot, Rebecca, Elodie Feller, Will Martindale, Margarita Pirovska, Rory Sullivan, *Fiduciary Duty in the 21st Century: Final Report*, UNEP FI, PRI (October 22, 2019), https://www.unepfi.org/publications/investment-publications/fiduciary-duty-in-the-21st-century-final-report/.
[55] *Addressing Climate as a Systemic Risk* at 30.
[56] *Fiduciary Duty in the 21st Century: Final Report* at 8, 11, 21. The common law jurisdictions covered by the report are Australia, Canada, South Africa, the UK (in respect to England and Wales) and the U.S. *Id.* at 11.
[57] *Fiduciary Duty in the 21st Century: Final Report* at 8, 10-20.
[58] *Investing in a Time of Climate Change: The Sequel 2019* at 16.
[59] *Investing in a Time of Climate Change: The Sequel 2019* at 16-17.

expected financial materiality of these risks is supported by reports from the Bank of England, the Financial Stability Board, and The Economist Intelligence Unit.[60]

Many institutional investors have adopted this view. In 2019, State Street Global Advisors (SSGA) surveyed senior executives with asset allocation responsibilities at over 300 institutions, including private and public pension funds, endowments, foundations and government institutions (sovereign wealth funds).[61] Globally, 46% percent of respondents viewed ESG as part of their fiduciary duty.[62] In North America, a higher percentage, 59%, viewed it as part of their fiduciary duty, naming it as the leading factor for their decisions to integrate ESG considerations into their work. Responses suggested that two responsibilities to beneficiaries drove this view: mitigating ESG investment risks and shaping a sustainable economy.[63]

A 2019 statement by the International Organization of Securities Commissions (IOSCO) included the following recommendation for securities regulators: "Consistent with their fiduciary duties, institutional investors, including asset managers and asset owners, are encouraged to incorporate ESG-specific issues into their investment analysis, strategies and overall governance, and take into account material ESG disclosures of the entities in which they invest."

Friede, Busch, and Bassen, in their metastudy *ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies*, drew this main conclusion from their research: "the orientation toward long term responsible investing should be important for all kinds of rational investors in order to fulfill their fiduciary duties and may better align investors' interests with the broader objectives of society. This requires a detailed and profound understanding of how to integrate ESG criteria into investment processes in order to harvest the full potential of value-enhancing ESG factors."[64]

The studies and trends noted above underscore that prudent investment practice requires investors to consider the impacts of ESG factors as a part of prudent investment practice. Under ERISA's duty of prudence, for example, the fiduciary must act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." § 404(a)(1)(B) of ERISA. This entails the courts "focus[ing] not only on the merits of the transaction, but also on the thoroughness of the investigation into the merits of the transaction." *Howard v. Shay*, 100 F.3d 1484, 1488 (9th Cir. 1996). A court's eye is "on a review of the fiduciary's independent investigation of the merits of a particular investment, rather than on an evaluation of the merits alone." *Donovan v. Cunningham*, 716 F.2d 1455, 1467

[60] *Investing in a Time of Climate Change: The Sequel 2019* at 16, citing Bank of England. *The Bank of England's Response to Climate Change*, Quarterly Bulletin (2017 Q2), https://www.bankofengland.co.uk/quarterly-bulletin/2017/q2/the-banks-response-to-climate-change; Financial Stability Board, *Climate-Related Financial Disclosures*, https://www.fsb.org/work-of-the-fsb/policy-development/additional-policy-areas/climate-related-financial-disclosures/; Economist Intelligence Unit, *The Cost of Inaction: Recognizing the Value at Risk From Climate Change* (2015), https://eiuperspectives.economist.com/sites/default/files/The%20cost%20of%20inaction_0.pdf.
[61] State Street Global Advisors, *Into the Mainstream: ESG at the Tipping Point* (November 2019) at 2, https://www.ssga.com/library-content/pdfs/insights/into-the-mainstream.pdf.
[62] *Into the Mainstream: ESG at the Tipping Point* at 8.
[63] *Into the Mainstream: ESG at the Tipping Point* at 8.
[64] *ESG and Financial Performance: Aggregated Evidence* at 227.

(5th Cir. 1983). Courts will look to the "totality of the circumstances" when evaluating whether a fiduciary acted prudently, including whether the fiduciary considered material investment risks. *See, e.g., DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 418 (4th Cir. 2007); *and Bunch v. W.R. Grace & Co.*, 555 F.3d 1, *7 (1st. Cir. 2009). Because it would be contrary to law for the Department to encourage fiduciaries to turn a blind eye to *material* investment risks and opportunities, whether ESG-related or not, I ask the Department to more clearly state that, when ESG issues present material risks or opportunities (*i.e.*, pecuniary-based), ERISA's fiduciary duties compel qualified investment professionals to consider them.

Therefore, we request that the Department more clearly state, in the final regulation (should the Department move forward with this proposed rule), that when ESG issues present *material* risks or opportunities (*i.e.*, they are pecuniary), ERISA's fiduciary duties would compel qualified investment professionals to consider them.

(3) The Department should retain the tie-breaker test, which allows for ESG factors to be considered for non-pecuniary reasons.

As the Department has recognized, ERISA's fiduciary duties "do not prevent plan fiduciaries from investing plan assets in [ESG] investments if the investment has an expected rate of return commensurate to rates of return of available alternative investments with similar risk characteristics, and if the investment vehicle is otherwise an appropriate investment for the plan in terms of such factors as diversification and the investment policy of the plan." 85 Fed. Reg. 39113, 39114. This is known as the tie-breaker test and it has been utilized by the Department (and relied upon by fiduciaries and market participants) over many years in the context of ESG and economically targeted investments. *See, e.g.*, DOL Adv. Op. 98-04A and DOL Adv. Op. 85-36A (Oct. 23, 1985).

The tie-breaker test has clear echoes of both ERISA and the common law of trusts. The fiduciary may consider, as part of its proper evaluation of a prospective investment under ERISA, common law and the tie-breaker test, myriad factors (*e.g.*, expected return, degree of risk, cost, liquidity and whether the investment is appropriate for the plan based on the plan's liquidity and other needs).[65] ERISA, trust law and the tie-breaker test were not designed to be straightjackets in how fiduciaries make investment decisions[66] or otherwise dictate to investment professionals which types of investments are *per se* prudent or imprudent.[67] Rather, substantive prudence duties are

[65] *See* 29 CFR § 2550.404a-1(b)(i) and Restatement (Third) of Trusts § 90, comment (k).
[66] *See, e.g.*, Restatement (Third) of Trusts § 90, comment (e)(1) ("The usual emphasis on long-term investing, however, does not prevent the use of active management strategies. Nor does it necessarily preclude a trust investment strategy that makes competent use of investments or techniques that are often characterized as risky or "speculative." Such investments (for example, real estate and venture capital) or techniques (for example, borrowing and options or futures transactions) are not prohibited as long as they are employed in a manner that is prudently designed to reduce the overall risk of the trust portfolio or to allow the trust, in appropriate circumstances, to achieve a higher return expectation without a disproportionate increase in the overall level of portfolio risk.").
[67] *See, e.g.*, *Leigh v. Engle*, 858 F.2d 361, 367-68 (7th Cir. 1988) ("When investment advisors make decisions, they do not view individual investments in isolation. Rather, the goal is to create a diversified portfolio that balances appropriate levels of risk and return for the investor. The risk of a given investment is neutralized somewhat when the investment is combined with others in a diversified portfolio. The risk inherent in the entire portfolio is less than that of certain assets within that portfolio. Ideally, after diversification only market risk remains. Likewise, the return from a portfolio over time should be more stable than that of isolated investments within that portfolio.

inherently flexible. Investments in blue chips *can* yield to investments in start-ups.[68] Investment strategies not yet the norm *may still* be prudent under ERISA, trust law and the tie-breaker test.[69]

Moreover, the fiduciary must always engage in a careful, deliberative process. A non-existent or haphazard decision-making process may taint the decision itself. Conversely, a fiduciary that carefully considers the relevant criteria, and meaningfully deliberates the proposed investment decision, demonstrates procedural prudence.[70] And so, fiduciaries cannot make decisions in the abstract but must undertake a process that reflects methods customarily used by other fiduciaries, such as pulling the requisite data and relying upon experts (as appropriate) in making an informed investment decision.[71] A methodical process that accounts for the aforementioned substantive factors is the heart of the duty of prudence.

I believe the Department should retain the tie-breaker test, which applies when the fiduciary considers an ESG investment for non-pecuniary reasons. As described above, the test is an extension of the existing prudence requirements under ERISA and the common law of trusts.[72] The Department should continue to have confidence in these protective principles and requirements, which have guided fiduciaries since ERISA's inception.

I worry, however, that statements in the proposed rule's preamble may suggest that the tie-breaker test is now no longer[73]a test remotely achievable. For example, the Department implies that the test fails unless the ESG investment and a non-ESG investment have the exact *same* performance history, fee structure, benchmark, investment strategy, and asset composition. 85 Fed. Reg. at 39117. Such interpretation would alter the tie-breaker test to no longer requiring a *comparison* but a *replication*, and it would mark a clear departure from ERISA and the

…Given the facts that investment advisors generally follow a portfolio strategy of investment and that beneficiaries whose assets are being managed are concerned with the end result of that strategy, not with the return on a single element in the portfolio, it makes sense for courts to look at the whole portfolio to determine the investment strategy's success.").

[68] *See, e.g.,* Preamble to the Final ERISA Prudence Regulation, 44 Fed. Reg. 37221.

[69] Restatement (Third) of Trusts, § 90, comment (e)(1) ("although it is ordinarily helpful in justifying the reasonableness of a trustee's conduct to show that an investment or strategy is widely used by trustees in comparable trust situations, the absence of such use does not render imprudent the informed, careful use of unconventional assets or techniques.").

[70] *See, e.g.*, *Donovan v. Walton*, 609 F.Supp. 1221 (S.D. Fla. 1985) ("ERISA 404(A)(1)(B) requires only that the Trustees vigorously and independently investigate the wisdom of a contemplated investment; it matters not that the investment succeeds or fails, as long as the investigation is "intensive and scrupulous and…discharged with the greatest degree of care that could be expected under all the circumstances by reasonable beneficiaries and participants of the plan." (*quoting Leigh v. Engle*, 727 F.2d 113, 124 (7th Cir. 1984)). *See also Katsaros v. Cody,* 568 F.Supp. 360 (E.D.N.Y. 1983); *DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 418, 420 (4th Cir. 2007); *and* Restatement (Third) of Trusts § 90, comment (d).

[71] *See, e.g.*, *GIW Indus. v. Trevor, Stewart, Burton & Jacobsen, Inc.*, 895 F.2d 729 (11th Cir. 1990). *See also Howard v. Shay*, 100 F.3d 1484, 1489 (9th Cir. 1996) (noting that while "securing an independent assessment from a financial advisor or legal counsel is evidence of a thorough investigation," a fiduciary should nevertheless investigate such expert's qualifications, provide the expert with complete and accurate information and ensure that reliance on the advice is reasonably justified).

[72] *See Chamber of Commerce of U.S. v. DOL*, No. 17-10238, 2018 BL 352943, *19 (5th Cir. 2018) ("The Supreme Court has warned that "there may be a question about whether [an agency's] departure from the common law…with respect to particular questions and in a particular statutory context[] renders its interpretation unreasonable" *citing NLRB v. Town & Country Elec., Inc.*, 516 U.S. 85, 94 (1995)).

[73] *See, e.g., Id.* ("DOL's turnaround from its previous regulation that upheld the common law understanding of fiduciary relationships alone gives us reason to withhold approval or at least deference for the [regulation].").

common law of trusts, as described above. This construction would have the effect of wresting away the investment professional's ability to consider and weigh the myriad factors (as highlighted above) that differentiate one investment opportunity from another and instead impose an overly simplistic and overly strict check-the-box exercise that leads to only one result. I do not think ERISA supports such an approach.[74]

The Department should retain the tie-breaker test under duty of loyalty considerations, as well. Where an ESG investment is being pursued for non-pecuniary reasons, the tie-breaker test already identifies and addresses a potential duty of loyalty issue.The tie-breaker test is essentially a restatement of the incidental benefit doctrine for ESG-related investments. As the Department is no doubt aware, the incidental benefit doctrine provides that a fiduciary's investment decision that is in the best interest of participants and beneficiaries, but which happens to incidentally benefit the fiduciary, is *not* a violation of ERISA's duty of loyalty. The incidental benefit doctrine reflects the reality that small, collateral, incidental benefits may indeed flow to a fiduciary or others from everyday plan investment decisions, while *still* being protective of participants' and beneficiaries' retirement security. This has been recognized by many courts. *See, e.g.*, *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982); *Morse v. Stanley*, 732 F.2d 1139, 1145, 1146 (2d Cir. 1984) ("It is no violation of a trustee's fiduciary duties to take a course of action which reasonably best promotes the interest of plan participants simply because it incidentally also benefits the corporation."). *See also Hugler v. Byrnes*, 247 F. Supp. 3d 223, 230 (N.D.N.Y. 2017) ("any benefit to the plan's fiduciary must be incidental to a decision that is otherwise independently in the best interests of the plan participants" (*citing In re State St. Bank & Trust Co. Fixed Income Funds Inv. Litig.*, 842 F. Supp. 2d 614, 649 (S.D.N.Y. 2012)); *and Dupree v. The Prudential Ins. Co. of America*, 2007 BL 261609, 51 (S.D. Fla. 2007) ("[w]here, however, a fiduciary takes action that arguably benefits both plan and non-plan interests, courts have held that some incidental benefit to other interests is permissible under the statute as long as the primary purpose and effect of the action is to benefit the plan."). The Department itself has also recognized that incidental, collateral benefits do not necessarily constitute impermissible conflicts of interest and self-dealing. DOL Adv. Op. 2000-10A (July 27, 2000).

The tie-breaker test and incidental benefits doctrine provide fiduciaries necessary breathing room while simultaneously protecting the interests of plan participants and beneficiaries in their retirement security. Whether the collateral and incidental benefit is ESG-related or not should make no difference. I respectfully request that the Department continue to offer the tie-breaker test.

By extension, and for the foregoing reasons, the Department should offer the tie-breaker test to fiduciaries who are selecting investment options for inclusion in defined contribution plan lineups. By requiring that a fiduciary "use[] only objective risk-return criteria" when selecting and monitoring investment alternatives, section (c)(3)(i)) of the proposed rule arguably prevents a fiduciary from even utilizing the tie-breaker test for these fiduciary decisions. The tie-breaker test was designed *precisely* for investment decisions not based entirely on pecuniary or objective bases. If a fiduciary may *only* use objective criteria based on risk-return criteria, as the proposed

[74] *See, e.g., Chamber of Commerce of U.S. v. DOL*, No. 17-10238, 2018 BL 352943, *17 (5th Cir. 2018) ("A perceived "need" does not empower DOL to craft *de facto* statutory amendments or to act beyond its expressly defined authority.").

rule expressly requires, there is seemingly no room and no chance for the fiduciary to base its decision on collateral and incidental benefits, *even if* the tie-breaker test were to be met. A disparate approach to how fiduciaries treat non-pecuniary ESG investments based on the nature of the plan is inappropriate and creates needless confusion.

Indeed, the Department has long recognized the importance of harmonization when it comes to non-pecuniary ESG investment decisions and the broad applicability of the tie-breaker test. *See* DOL Adv. Op. 98-04A; *see also* FAB 2018-01 *and* IB 2015-01. I, therefore, urge the Department to state that an ERISA fiduciary may rely upon the tie-breaker test when selecting and monitoring, for non-pecuniary reasons, designated investment alternatives and other plan investment options.

(4) The Department should rely upon its existing, protective framework in whether a ESG fund (pecuniary or non-pecuniary) may constitute a QDIA or component of a QDIA.

I call on the Department to reexamine its position on ESG in the context of "qualified default investment alternatives," within the meaning of 29 C.F.R. § 2550.404c-5 (QDIAs). The proposed rule provides that, "the environmental, social, corporate governance, or similarly oriented investment mandate alternative [may not be] added as, or as a component of, a [QDIA]." ((c)(3)(iii)). I certainly appreciate the special character, and importance, of QDIAs for many participants and beneficiaries in their retirement security. But there is already a well-understood protective framework in place with respect to both the selection and monitoring of QDIAs.

Consider first that the selection and monitoring of a QDIA, whether ESG-related or not, "is a fiduciary act and, therefore, ERISA obligates fiduciaries to act prudently and solely in the interest of the plan's participants and beneficiaries." 72 Fed. Reg. 60451, 60453 (Preamble) (Dec. 24, 2007). *See also Tibble v. Edison Int'l*, 575 U.S. 523 (2015). ERISA's fiduciary duties, including when applied to selecting investment options for a 401(k) plan lineup, are exacting and are "the highest known to the law." *Bierwirth*, 680 F.2d at n.8. ERISA's duty of loyalty, for example, requires the fiduciary to act "with an eye single to the interests of the participants and beneficiaries." *Id. at* 271. ERISA's duty of prudence, moreover, focuses the attention on both the merits of the transaction, as well as the thoroughness of that decision-making process. *Howard v. Shay*, 100 F.3d 1484, 1488 (9th Cir. 1996). As noted above, courts will ultimately look to the "totality of the circumstances" when evaluating fiduciary conduct. *DiFelice*, 497 F.3d at 418.

If a fiduciary selects an ESG-related QDIA for *pecuniary* reasons, the analysis should begin and end with longstanding interpretations of ERISA's fiduciary duties, as well as the QDIA regulation, 29 C.F.R. § 2250.404c-5 specifically with respect to the fiduciary protection conferred under that safe harbor. A fiduciary that wishes to select an ESG-related QDIA for *non-pecuniary* reasons (*i.e.*, in whole or part for collateral benefits) already remains bound to the QDIA regulation (again, for purposes of availing itself of the protection under that safe harbor), ERISA's fiduciary duties, *as well as* the traditional tie-breaker test. As discussed earlier, the tie-breaker was developed precisely to address how non-pecuniary investments (including the selection of investment options in plan lineups) can be pursued in a manner consistent with ERISA's fiduciary duties. Like the incidental benefit doctrine, the traditional tie-breaker test is an extra shield used to allow some breathing room for fiduciaries while protecting the interests of participants' and beneficiaries' in their retirement income, as required under ERISA. The Department should resist the temptation to reinvent the wheel by discarding this long-standing practice.

I also note the point made by the Department in the preamble to the proposed rule that, "in the QDIA context a fiduciary's decision to favor a particular environmental, social, corporate governance, or similarly oriented investment preference—and especially a decision to favor the fiduciary's own personal policy preferences—would raise questions about the fiduciary's compliance with ERISA's duty of loyalty." 85 Fed. Reg. at 39119. But consider that duty of loyalty concerns arising in the ESG context are a principal reason why the traditional tie-breaker test was developed in the first place. I know this because the Department's own authority has *broadly* applied the tie-breaker test to ERISA's fiduciary duties under §§ 403 and 404 of ERISA. *See, e.g.*, IB 2015-01 *and* DOL Adv. Op. 98-04A. If there is a duty of loyalty concern, such as where a fiduciary is selecting an investment option or making some other fiduciary decision that confers some benefit to itself,[75] then the existing framework of the traditional tie-breaker test is *already* in place to protect the interests of the plan participants and beneficiaries.

In conclusion, the proposed rule is unnecessary, ill advised, inconsistent with the correct interpretation of fiduciary duty under ERISA, and inconsistent with widespread current investment practice. I therefore urge the Department to withdraw, or substantially modify it, in accordance with the above facts, evidence and considerations. I have also appended three attachments containing the complete source materials cited in the footnotes.

Finally, I respectfully request that the Department extend the comment period from 30 to 120 days. The Department first issued guidance on this topic over 25 years ago, and it is a matter of utmost concern to institutional investors. The importance of ESG issues to investors, companies and the U.S. economy has been extensively researched. Extending the comment period will

[75] I agree with the Department that ERISA requires fiduciaries to act for the exclusive purpose of providing benefits to participants. If I consider Congress' purpose for enacting ERISA, and the statute's text, the term *benefits* "must be understood to refer to the sort of financial benefits (such as retirement income) that trustees who manage investments typically seek to secure for the trust's beneficiaries." *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, 420-21 (2014). Policy or political preferences of participants, which are likely to be numerous and competing, are not the type of benefits Congress sought to protect under ERISA. *See, e.g.,* DOL Adv. Op. 2008-05A (June 27, 2008) ("The ERISA statute, and all subsequent guidance issued by the Department, makes it clear that in deciding whether and to what extent to make, or refrain from making, a particular investment, a fiduciary may only consider factors relating to the interests of plan participants and beneficiaries in their retirement income."); *and* DOL Adv. Op. 2007-07A (Dec. 21, 2007) ("The Department has previously expressed strong concern about the use of plan assets to promote particular legislative, regulatory or public policy positions that have no connection to the payment of benefits or plan administrative expenses."). I further add that the duty of loyalty requires the fiduciary to "deal even-handedly among [participants and beneficiaries], doing his best for the entire trust looked at as a whole." *Morse v. Stanley*, 732 F.2d 1139, 1145 (2d Cir. 1984). *See also Varity Corp.*, 516 U.S. at 514 ("The common law of trusts….requires a trustee to take impartial account of the interests of all beneficiaries."); *Talarico v. United Furniture Workers Pension Fund*, 479 F. Supp. 1072, 1081 (D. Neb. 1979) ("…the Trustees of the Fund must exercise their discretion to serve the interests of all the participants in the Fund."); *and Winpisinger v. Aurora Corp. of Illinois, 456 F. Supp. 559, 566 (N.D. Ohio 1978)*("In addition to reinforcing the prohibition against self-dealing provided by [§ 1104](A), the lead line of [§1104](a)(1) is construed to require that in the discharge of his duties with respect to a plan (referring to the administration of a plan rather than to its establishment) the fiduciary is forbidden from granting preference as between a plan's participants or as between a plan's beneficiaries.").

provide investors and other stakeholders enough time to provide meaningful substantive feedback on the proposal.

I would like to provide my appreciation to Jim Coburn, Senior Manager, Disclosure for drafting this letter. If you have questions or thoughts, please contact us at coburn@ceres.org.

Sincerely,

Mindy S. Lubber
CEO and President
Ceres, Inc.

cc: Honorable Eugene Scalia, Secretary of Labor