FCLTGLOBAL
FOCUSING CAPITAL ON THE LONG TERM

15 July 2020

U.S. Department of Labor
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Office of Regulations and Interpretations, Employee Benefits Security Administration
Room N-5655, U.S. Department of Labor
200 Constitution Avenue NW, Washington, DC 20210
Attention: Financial Factors in Selecting Plan Investments Proposed Regulation

Re: U.S Department of Labor Request for Public Comment on Financial Factors in Selecting Plan Investments Amending "Investment duties" [Regulation at 29 CFR 2550.404a-1]

Summary: FCLTGlobal is a 501(c)3 not-for-profit research organization that works to encourage a longer-term focus in business and investment decision-making by developing practical tools and approaches to support long-term behaviors across the investment value chain. Focusing Capital on the Long Term began in 2013 as an initiative of the CPP Investments and McKinsey & Company, which together with BlackRock, Dow, and Tata Sons founded FCLTGlobal in July 2016. In addition to our Founders, today our 50 Member organizations span the investment value chain, including asset owners, asset managers and corporations, and are committed to accomplishing long-term tangible actions to lengthen the timeframe of capital allocation decisions. Please visit www.fcltglobal.org for more information.

The Department of Labor ("The Department") is inviting public comments on a proposal to codify a regulatory structure for the Department's current "Investment duties" regulation at 29 CFR 2550.404a-1. This amendment would assist ERISA fiduciaries in establishing regulatory guidelines for plan fiduciaries in light of recent environmental, social, and governance (ESG) investment trends. The Department of Labor has voiced concerns[1] that these trends may lead plan fiduciaries to "choose investments of action to promote environmental, social, and public policy goals unrelated to the interests of plan participants and beneficiaries in financial benefits from the plan and expose plan participants and beneficiaries to inappropriate investment risks".

Based on FCLTGlobal's review of existing academic evidence, our own analysis, and research informed by our multi-year conversations with our Members and other experts, we suggest the Department carefully consider the following:

- The duty of ERISA fiduciaries is to provide financial retirement benefits often many years into the future

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[1] "Notice of Proposed Rulemaking on Financial Factors in Selecting Plan Investments Amending 'Investment Duties' Regulation at 29 CFR 2550.404a-1," U.S. Department of Labor , June 23, 2020, https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/financial-factors-in-selecting-plan-investments.

- Considering the long-term performance of companies and investments is critical to providing those benefits
- Ignoring long-term trends that may affect the financial value of investments because they fall into the category of ESG issues would be a violation of fiduciary duty

Clarification of the Long-term Nature of Fiduciary Duty

ERISA fiduciaries have a clear duty: to provide retirement benefits many years into the future. As the Department states[2], fiduciaries must "select investments and investment courses of action based on financial considerations relevant to the risk-adjusted economic value of a particular investment or course of action." What is important for the Department to recognize is that this economic value develops over many years, and that ERISA fiduciaries must keep the often multi-decade life of their liabilities in mind as they select the appropriate course of action.

Long-term Companies Outperform

Research from the McKinsey Global Institute and FCLTGlobal[3] shows that long-term firms deliver superior financial performance – long-term firms added more revenues, profitability, and market value than other firms between 2001 and 2014. The strong fundamentals exhibited by these long-term companies allowed them to better weather the 2008 global financial crisis and its aftermath.

FCLTGlobal analysis[4] also found that companies with: 1) Fewer ESG related controversies and; 2) A higher percentage of long-term investors (measured as the percent of company shares held by firms with < 50% dollar turnover or holding period of <2 years) in their investor base outperform their peers.

Evidence that long-term companies outperform suggests that investors who invest in long-term companies ultimately provide better long-term financial performance for their plan beneficiaries.

Long-term Risks and Opportunities as Critical Elements

For institutional investors to fulfill their fiduciary duty, they must account for the risks and opportunities that will affect the long-term value of their investments. Estimating risks such as climate change,

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[2] "Notice of Proposed Rulemaking on Financial Factors in Selecting Plan Investments Amending 'Investment Duties' Regulation at 29 CFR 2550.404a-1," U.S. Department of Labor , June 23, 2020, https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/financial-factors-in-selecting-plan-investments.

[3] Dominic Barton, et al, "Measuring the Economic Impact of Short-termism," McKinsey Global Institute, McKinsey & Company, February 2017, https://www.fcltglobal.org/resource/measuring-the-economic-impact-of-short-termism/#0.

[4] Bhakti Mirchandani, et al, "Predicting Long-Term Success for Corporations and Investors Worldwide," FCLTGlobal, September 2019, https://www.fcltglobal.org/resource/predicting-long-term-success-for-corporations-and-investors-worldwide/.

employment practices, and board structures is critical to making investment decisions. One only has to look to the cost to investors of forest fires to PG&E[5], harassment to Wynn Casinos[6], or lack of environmental focus to Volkswagen[7] to see the clear cost of ignoring such issues. Over longer time frames those are indeed material risks[8] and opportunities that prudent fiduciaries must consider.

According to a survey about climate risk perceptions, "institutional investors believe climate risks have financial implications for their portfolio firms and that these risks, particularly regulatory risks, already have begun to materialize"[9]. Investors who incorporate the risk of climate change[10], for example, into their investment decisions are more likely to find financial success for their beneficiaries.

Not considering ESG issues could be appropriate for investors with short-term time horizons. However, over time, ESG issues may become material[11].

Organizations that care about society's best interests, and that implement good ESG practices, are more forward-thinking and positioned for success in the long term. For example, climate change creates both risks to some investments[12] and opportunities to allocate capital toward innovations and solutions[13]. Estimating the impact of climate change (and the likelihood of a future carbon price) is critical to making investment decisions. Firms and investors who incorporate these risks and opportunities into their decision-making process today are more likely to find financial success because they build the economy of the future, one that is sustainable and resilient.

To position portfolios for the long term, fiduciaries need to recognize society's most pressing problems, such as climate change, discrimination, and fair wages, and recognize that these issues will affect the companies and economies they invest in – and therefore affect their financial return.

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[5] "PG&E:California power firm to pay $13.5bn to wildfire victims," BBC News, December 2019, https://www.bbc.com/news/world-us-canada-50697816.

[6] Bailey Shulz, "9 female employees file new lawsuit against Wynn Resorts," Review Journal, October 2019, https://www.reviewjournal.com/business/casinos-gaming/9-female-employees-file-new-lawsuit-against-wynn-resorts-1861049/.

[7] U.S. Environmental Protection Agency, "Volkswagen Clean Air Act Civil Settlement," 2019, https://www.epa.gov/enforcement/volkswagen-clean-air-act-civil-settlement.

[8] George Serafeim, et al, "Corporate Sustainability: First Evidence on Materiality," The Accounting Review, 2016, https://meridian.allenpress.com/accounting-review/article-abstract/91/6/1697/99330.

[9] Philipp Krueger, et al, "The Importance of Climate Risks for Institutional Investors," Swiss Finance Institute Research Paper No. 18-58, August 2018, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3235190.

[10] "Investing in a time of climate change," Mercer in partnership with The International Finance Corporation, 2015, https://www.ifc.org/wps/wcm/connect/e9bfa328-e091-465b-9da6-8fe312261b98/Investing+in+a+time+of+climate+change.pdf?MOD=AJPERES&CVID=kTFEATf.

[11] George Serafeim, et al, "Corporate Sustainability: First Evidence on Materiality," The Accounting Review, 2016, https://meridian.allenpress.com/accounting-review/article-abstract/91/6/1697/99330.

[12] "Investing in a time of climate change," Mercer in partnership with The International Finance Corporation, 2015, https://www.ifc.org/wps/wcm/connect/e9bfa328-e091-465b-9da6-8fe312261b98/Investing+in+a+time+of+climate+change.pdf?MOD=AJPERES&CVID=kTFEATf

[13] Erik Kobayashi-Solomon, "Climate Change Investing: The Greatest Opportunity In History," Forbes, January 2019, https://www.forbes.com/sites/erikkobayashisolomon/2019/01/04/climate-change-investing-the-greatest-opportunity-in-history/#96326df3e34f.

Conclusion

The Department acknowledges that "ESG factors can be pecuniary factors.[14]" We would encourage the Department to recognize that with a multi-decade timeframe, ESG factors are likely to become pecuniary factors. As pecuniary factors, they not only merit consideration by ERISA fiduciaries but must be part of the investment process.

Retirement plans and their asset managers have a fiduciary duty to maximize returns in the long term to provide retirement payments in the distant future. A clear relationship exists between a company's culture, business practices, and place in society and its ability to achieve sustained positive financial results. For institutional investors to fulfill their fiduciary duty, they cannot ignore risks and opportunities that will affect the value of their investment in the long term. The fact that those risks and opportunities are labeled "ESG" does not make them any less important in the exercise of this fiduciary duty.

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[14] Notice of Proposed Rulemaking on Financial Factors in Selecting Plan Investments Amending 'Investment Duties' Regulation at 29 CFR 2550.404a-1," U.S. Department of Labor , June 23, 2020, https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/financial-factors-in-selecting-plan-investments