LEON M. METZGER

July 19, 2020

The Honorable Eugene Scalia
Secretary
U.S. Department of Labor
200 Constitution Ave. NW
Washington, DC 20210
RE: Financial Factors in Selecting Plan Investments (RIN 1210-AB95)

Dear Secretary Scalia:

By way of background, I have more than 30 years of business, academic, and testifying experience with asset-management-industry practices. I have testified three times before Congress about capital markets, private funds, and operational controls, and have appeared as an expert on valuations and private funds before various US government departments, such as the Treasury, IRS, SEC, CFTC, and GAO. I have taught graduate-level courses that provide an overview of operating private funds, at a number of schools including, the graduate business schools of NYU, Wharton, and Yale, and Yale Law School. In the context of this letter, I have lectured about ESG in the classroom, and at professional-society and corporate training sessions, and testified as an expert about this subject in arbitration.

Recently, ESG, as a doing-well-by-doing-good investment strategy, has become a popular platitude. I write to applaud the DOL's recent proposal discouraging retirement-plan fiduciaries from considering ESG criteria in their investment decisions relating to ERISA-governed retirement plans, if such investments could sacrifice investment returns or would assume additional investment risk.

In theory, ESG investing allows investors to support long-term change by building a system that rewards and values ESG. When deciding whether to invest in securities, individuals—but not fiduciaries, which were assigned to the retirement savers and which the savers did not choose—should be able to consider subjective criteria, for example, whether companies have established diverse leadership teams and foster inclusive or discriminatory workplaces, if these conditions are important to them, even if such investment would lower the expected return of the individual's portfolio or increase risk. While I personally can choose to invest in any company I deem to have ethical traits, you might not consider such company morally responsible. If so, who should judge which company is ESG-mandate compliant if yours and my investments are pooled?

One can subjectively find good and bad things in just about every company. For example, service providers, which claim to be experts in deciding which companies are ESG-mandate compliant, often disagree which are the better compliant ones. Along these lines, a manufacturer was ranked the highest on sustainability by one rating firm while that same company was ranked the lowest on ESG issues by a different rating firm. Simply put, not everyone agrees what is positive ESG and which investments meet that standard.

Studies conflict as to whether ESG-based investing enhances or sacrifices investment returns. Even if ESG investments sometimes outperform traditional investments and the overall financial markets, sometimes they do not. Those in the ESG ecosystem, e.g., data providers, fee-earning sponsors of ESG funds, advocacy organizations, assurance providers, and broker/dealers, who earn commissions when their ESG recommendations are followed, may have a self-serving reason to highlight those studies that conclude that greater-ESG-mandate-compliant investments outperform less-compliant ones and to ignore the studies that conclude the opposite. For instance, a recent article said that firms see an embrace of ESG as a way to collect more fees. Moreover, an overwhelming number of studies suggest that passive investing outperforms active investing; in response, active managers, according to an article, are launching ESG funds to keep funds under management and justify fees.

Some industries face more ESG risk than others do. If fiduciaries choose the companies with the best scores on an absolute basis, portfolios could become less diversified and more concentrated in fewer industries.

To be absurd, would an ESG-mandate-compliant pension fund not be allowed to invest in US Treasuries because, for example, last week the federal government, after a 17-year break from capital punishment, executed three people, if the fiduciary of the fund finds capital punishment to be morally repugnant?

Michael Porter, George Serafeim, and Mark Kramer have pointed out that a bank that makes predatory loans but has a low carbon footprint might have a high ESG score although the carbon footprint is immaterial to the bank's economic performance, while the loans, which are material to economic performance, are insignificant to the score.

Often, socially responsible investing is disguised as ESG. Many years ago, I told my students, "Socially responsible investing is a great idea in theory, but when you realize how difficult it is to implement, you wonder whether it's just a feel-good slogan, at best, or a marketing gimmick, at worst. What you find socially responsible I may deem socially irresponsible, and what I think is sensible you may believe is not. Beauty is in the eyes of the beholder. Because positive screens miss the negative aspects and negative monitors forego the positive ones, the only way you may really achieve the goals of SRI is, by way of engagement, to change a company from the inside."

Indeed, as SEC Commissioner Hester M. Peirce said in 2018, "The problems arise when those making the investment decisions are doing so on behalf of others who do *not* share their ESG objectives. This problem is most acute when the individual cannot easily exit the relationship. For example, pension beneficiaries often must remain invested with the pension to receive their benefits. When a pension fund manager is making the decision to pursue her moral goals at the risk of financial return, the manager is putting other people's retirements at risk."

I understand that some say that ESG-based investing is a key way to grow a retirement plan without sacrificing investment returns, if not materially improving an investment's long-term financial performance. I have seen empirical data that both support and refute that assertion about performance. Unless the data conclusively support the assertion, I cannot agree with those advocates. (Parenthetically, if an adviser bought today a group of securities that it felt would be recommended, in the near-term, by the ESG ecosystem, such a so-called ESG-strategy might pass muster because it would be a profit-seeking one. In fact, investors in such a strategy might not buy into the concept of ESG; their motivation would be to identify securities whose demand would increase, which would lead to higher valuations.)

To summarize, there could be a place for ESG investments, but only if the individual can decide directly, or indirectly by way of the individual's designated arbiter, what is ESG-mandate compliant. Thus, your proposal is logical. I agree with the DOL that, for retirement savings plans, earning returns-commensurate-with-risk is more important than implementing subjective ESG.

If you have any questions about this comment letter or other opinions I might have about ESG, please do not hesitate to contact me.

Respectfully submitted,

Leon M. Metzger