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Submitter Information

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General Comment

In response to the Department of Labor's proposed rule, "Financial Factors in Selecting Plan Investments" (RIN 1210-AB95) (the "Proposal"):

As an Assistant Professor of Political Science, my work has focused in recent years on the role of financial institutions in energy and environmental governance. Given my research, I am especially concerned about this Proposal for two main reasons, both of which reveal fundamental misunderstandings of the relationship between financial returns and matters of environmental change, social engagement, and corporate governance. First, the proposed rule suggests that addressing ESG concerns might violate fiduciary duty; and second (and relatedly), it presents ESG concerns as "non-pecuniary." Yet the growing evidence from the scholarship in business and economics fields demonstrates that ESG concerns are material and that portfolios with concern for ESG factors outperform those that do not consider these aspects of operations and risk.

For more than a decade, research in economics and finance has demonstrated that investments that consider environmental factors are competitive withand may outperformthose that do not screen for these risks [1]. From an analysis of over 900 firms, Kumar et al. find that "companies that incorporate Environmental, Social and Fair Governance (ESG) factors show lower volatility in their stock performances than their peers in the same industry, that each industry is affected differently by ESG factors, and that ESG companies generate higher returns" [2]. Other literature confirms that "companies that address material ESG issues and ignore immaterial ones outperform those that address both material and immaterial issues by 4 percent and outperform companies that address neither by nearly 9 percent" [3]. For retirement funds, lower volatility

and higher returns are priorities; regulations should not be passed that limit fund managers' abilities to take into consideration the factors that will enable these outcomes.

ESG concerns are material to the financial performance of firms. The nature of these material concerns depend, of course, on the firm and the sectornot all ESG factors are equally relevant across industries and companies. A more-than-decade-long study of over 8000 European firms (2002-2014) reveals that the social performance of firms reduces idiosyncratic and total risk in general, while environmental performance decreases total and systematic risk in industries that are environmentally sensitive [4]. Firms are unevenly exposed to different risks. For financial responsibility, then, fund managers must be enabledand requiredto assess these risks. Far from being a distraction from financial concerns, assessing ESG factors is a central component of fiduciary responsibility.

The importance of ESG concerns to financial performance does not depend on the preference of investors for sustainability. As Verheyden et al. found, there is "almost no evidence that ESG screening reduces returns, but considerable evidence of reductions in risk" [5]. Incorporating ESG information into investment decisions is important for all investorsthese are pecuniary matters, rather than moral add-ons to portfolio design.

If the proposed rule is adopted, there may be perverse economic consequences: such a rule might limit plan diversification and might prevent plan fiduciaries from being able to systematically account for investment risks in their portfolios. In light of the dual responsibilities of these plan fiduciaries to limit the risk of large losses and prioritize retirement plan returns, it is financially and politically irresponsible to remove regulations that enable them to account for these material risks. I encourage you to reconsider and to withdraw the Proposal.

Thanks for your consideration,
Sincerely,
Dr. Kate Neville, Assistant Professor, University of Toronto

References:

[1] Repetto, Robert. 2005. Protecting investors and the environment through financial disclosure. Utilities Policy, 13: 51-68.

[2] Kumar, N. C. Ashwin, Camille Smith, Lela Badis, Nan Wang, Paz Ambrosy, & Rodrigo Tavares. 2016. ESG factors and risk-adjusted performance: a new quantitative model. Journal of Sustainable Finance & Investment, 6(4): 292-300.

[3] Bailey, Jonathan, Bryce Klempner, & Josh Zoffer. 2016. Sustaining sustainability: What institutional investors should do next on ESG. McKinsey on Investing, 3(summer): 1-8, http://baiii.org/wp-content/uploads/2018/08/Sustaining-Sustainability_-What-Institutional-Investors-Should-do-Next-on-ESG-Authored-by-Jonathan-Bailey-Bryce-Klempner-Josh-Zoffer-McKinsey-Company.pdf

[4] Sassen, Remmer, Anne-Kathrin Hinze, & Inga Hardeck. 2016. Impact of ESG factors on firm

risk in Europe. Journal of Business Economics, 86: 867-904.

[5] Verheyden, Tim, Robert G. Eccles, & Andreas Feiner. 2016. ESG for all? The impact of ESG screening on return, risk, and diversification. Journal of Applied Corporate Finance, 28(2): 47-55.