July 29, 2020

The Honorable Eugene Scalia
Secretary of Labor
U.S. Department of Labor
200 Constitution Avenue NW
Washington, D.C. 20210

RE: Financial Factors in Selecting Plan Investments under ERISA, 29 CFR Part 2550 (RIN 1210–AB95) – NYS DFS Comments

Submitted electronically via *regulations.gov*

Dear Secretary Scalia:

On behalf of the New York State Department of Financial Services (DFS), we respectfully offer comments on the Proposed Rule, dated June 30, 2020, which would revise the Department of Labor's regulation on investment duties under the Employee Retirement Income Security Act of 1974 (ERISA) "to make clear that ERISA plan fiduciaries may not invest in ESG vehicles when they understand an underlying investment strategy of the vehicle is to subordinate return or increase risk for the purpose of non-financial objectives."

For the reasons set forth below, DFS believes the Proposed Rule if adopted would likely undermine the retirement security of workers rather than protect it. Overall, DFS is concerned that the Proposed Rule would impede environmental, social, and governance (ESG) consideration for workers' retirement funds and the market more broadly, which would result in suboptimal financial performance. Studies have shown adopting ESG factors in investing contributes positively to financial returns.

DFS supervises and regulates the activities of approximately 1,500 banking and other financial institutions with assets totaling more than $2.6 trillion, more than 1,400 insurance companies with assets of more than $4.7 trillion, and New York pension funds. DFS's mission is to protect consumers and the financial market from fraud, promote the safety and soundness of the financial industry and guard against financial crises, and ensure that the regulation of financial services in New York adapts to the constant innovation of these industries.

New York is committed to protecting public workers' pensions by advancing consideration of ESG and climate-related financial risks, and, where appropriate, by supporting divestment from asset classes where such risks are unmanageable. Last year, New York passed the nation's most ambitious climate law to protect our communities and ensure a sustainable future. The law requires all state agencies take climate and climate-related risk into account.

In line with New York's new climate law and Governor Andrew M. Cuomo's climate action agenda, DFS in particular takes the threats posed by climate change very seriously and expects the companies we regulate to do the same. With $4.7 trillion in insurance-related assets in New York State—including consumers' property, health, and welfare that insurance is designed to protect—there is simply too much at stake to stand by and do nothing. Government and the financial services industry must each do their part while working together—or pay the price for failing to do so.

In September, DFS joined the Sustainable Insurance Forum, "a network of leading insurance supervisors and regulators seeking to strengthen their understanding of and responses to sustainability issues for the business of insurance", and became the first and only state or federal U.S. financial regulator to join the Network for Greening the Financial System, a network of global central bankers and financial regulators working on developing environmental and climate risk management in the financial sector.

In addition, the New York Common Retirement Fund has committed to integrating ESG and climate-related financial risk into its approach, as a tool in delivering the best financial performance. The Fund has developed a Climate Action Plan to protect and invest the $210 billion in assets of New Yorkers. Furthermore, the New York State Energy Research and Development Authority Other Post-Employment Benefits Trust, which funds health insurance benefit payments, now has social responsibility investment guidelines that consider minimizing investments in the fossil-fuel industry where appropriate while, as always, putting the economic interests of the plan first. New York is joined by other states, including California, Connecticut, Illinois, New Jersey, and Washington, which have also taken significant action to address ESG risks to the performance and resilience of public pensions.

As a regulator of financial institutions and pension funds, DFS shares the Department of Labor's commitment to ensuring retirement security, which is precisely why we feel strongly that adopting the Proposed Rule would be a mistake. We are concerned that the Proposed Rule puts in place barriers discouraging ESG investing to the detriment of workers and the market more broadly. In our view, the rise of ESG investing in recent years is a welcome development that reflects both a more sophisticated approach to investment and risk analysis and one more in line with the challenges facing investors today. Rather than embracing and supporting this positive market trend, the Proposed Rule could discourage fiduciaries from engaging in ESG analysis in their decision-making, resulting in worse outcomes for workers.

Instead of making it more difficult to use ESG factors to understand and manage risk, the federal government should take actions to develop better transparency and a deeper understanding of how ESG risks, and climate-related financial risks in particular, impact the financial system, the economy, workers, and their pensions. Such actions should include stress testing for resilience to climate-related financial risk, including physical and transition risks, and common rules of the road for federal agencies. This is the approach that governments are taking around the globe and that we in New York are considering as part of our own comprehensive approach to supporting investors and the financial market in these challenging times. Putting up roadblocks like the Proposed Rule will only hurt the global competitiveness of U.S. companies and harm the returns of U.S. pensions.

ESG adoption has arguably been the dominant market development in recent years, and for good reason. According to the Global Sustainable Investment Alliance, ESG investing totaled approximately $30 trillion in assets under management as of year-end 2018. Deloitte Touche Tohmatsu Limited recently found that "[g]lobally, the percentage of both retail and institutional investors that apply environmental, social, and governance (ESG) principles to at least a quarter of their portfolios jumped from 48 percent in 2017 to 75 percent in 2019." Investors are not turning to ESG because they suddenly no longer care about investment performance or have shrinking dreams for their retirements, but rather because they recognize that greater focus on the broad risks and social contexts in which companies operate is not only good for the world, but also, critically, better for investment returns as well.

Mounting evidence shows ESG investing has improved the quality of the investments. For example, Morningstar, Inc. recently found that "Sustainable funds comfortably outperformed their peers in 2019. The returns of 35% of sustainable funds placed in the top quartile of their respective categories, and nearly two thirds finished in the top two quartiles." Importantly, during the market downturn caused by COVID-19, "in the first quarter of 2020, Morningstar reported 51 out of 57 of their sustainable indices outperformed their broad market counterparts, and MSCI reported 15 of 17 of their sustainable indices outperformed broad market counterparts - robust across region and index methodology."[1]

The investment case for ESG analysis is arguably stronger now than even six months ago. On top of the ongoing and accelerating climate crisis, the country is now witnessing economic turmoil and rising social unrest

[1] BlackRock, Sustainable Investing: Resilience amid Uncertainty.

in the wake of the COVID-19 pandemic and the killing of George Floyd. Companies and investors will be increasingly challenged in this broader social landscape, which calls for precisely the sort of analysis that is at the heart of ESG investing.

The best regulatory and policy approach for investors and the financial market as a whole is to support and promote this developing framework rather than discourage it, as the Proposed Rule appears designed to do. To the extent that the Proposed Rule is rooted in a professed concern about the lack of rigor and/or uniformity in ESG analysis and ratings, it ignores both the virtue of diverse views and, more fundamentally, the tremendous progress the financial market has developed around ESG disclosure through critical and consensus-driven frameworks advanced by, among others, the Taskforce for Climate-related Financial Disclosure (TCFD) and the Sustainability Accounting Standards Board. These frameworks together have gained the support of thousands of corporations and asset managers -- across public and private equities and, increasingly, in credit market -- as well as from many national, state and local governments. Furthermore, signatories of United Nations Principles for Responsible Investments, which now integrates the TCFD framework in its annual reporting requirements, represent $90 trillion in assets. The market is keenly focused on ESG and climate-related financial risks, and, through rigorous frameworks, is developing approaches to better manage capital – often capital sourced from individuals' pensions.

Put simply, the nature of the challenges facing investors in today's market calls for broader and more sophisticated consideration of investment risks and opportunities. As a financial regulator, we believe the best way to serve investors is to identify proactive ways to support, develop, and reinforce the market's move in that direction, not to inhibit it as the Proposed Rule would do.

Thank you for the opportunity to submit comments on the proposed rulemaking. Please do not hesitate to contact Yue (Nina) Chen, Director of Sustainability and Climate Initiatives, at nina.chen@dfs.ny.gov to provide further information.

Sincerely,

Linda Lacewell
Superintendent of the New York State Department of Financial Services