SIERRA CLUB FOUNDATION

THE FOUNDATION FOR A HEALTHY PLANET.

July 29, 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,

This comment is being submitted by the Sierra Club Foundation. The Sierra Club Foundation provides a 403(b) benefit to 8 employees. We are opposed to the proposed rule and request that it be withdrawn because the adoption of the rule may result in diminished risk-adjusted returns for our beneficiaries, thus defeating the purpose for which the rule was crafted in the first place.

We believe that we can prudently enhance returns for our beneficiaries by investing in funds that overweight the securities of companies with more sustainable business models and underweight those with less sustainable business models. Sustainability implies that a company offers products and services that are in growing demand at reasonable prices. It also implies that its workforce, including that of its supply chain, is stable and appropriately skilled. It also implies that it is not subject to undue regulatory, legal, or technology risk. It also implies that the company possesses a social license to operate. Sustainability means that a company exhibits the ability to survive and thrive long-term when faced with rapidly changing economic conditions. This is the essence of sustainable investing. Sustainable investing is not simply, as the Department puts it, an "environmental, social, corporate governance, or similarly oriented investment mandate," although environmental, social and corporate governance considerations certainly enter into the investment decision process. Sustainable investing looks at the totality of risk and opportunity that every company faces. The intent of sustainable investing is often to provide solely pecuniary benefits, in a style known as "ESG integration." The proposed rule completely overlooks this variety of sustainable investing, which is dominant in the U.S. Its view of sustainable investing is an antiquated conception of "negative screening" that dates from the days of the South African divestment movement of the mid-1980's, and is in desperate need of updating.

How sustainable investing enhances investment returns

Investing in companies which are proactive in anticipating environmental and social risks and opportunities, and avoiding those which are not, enhances returns in at least four ways:

1. Transparency regarding environmental and social practices improves returns;
2. Progress on social and environmental practices can reduce the cost of capital;
3. Money flows into sustainable funds may cause the constituents of these funds to outperform;
4. Anticipation of risks can help companies to avoid or mitigate disastrous impacts on their securities prices.

Transparent disclosure of environmental and social practices enhances returns

Several studies have connected increased transparency of disclosure with better financial performance.[1] This work has recently been carried forward in the area of environmental and social disclosures. Khan et al.[2] find that the stock performance of firms with good ratings on material sustainability disclosure topics is significantly better than firms with poor ratings on these issues. Since that study was published it has been replicated by Russell Investments[3] and TruValue Labs.[4] There is little doubt that fiduciaries consider ESG information to be financially material; among the world's largest asset managers, both BlackRock[5] and State Street Global Advisors[6] have incorporated financially material sustainability disclosure into their proxy voting guidelines.

Progress on social and environmental practices can reduce the cost of capital

Perhaps the Department has not heard of sustainability-linked loans.[7] These loans, often used to refinance consortium loans, link preset sustainability targets, such as reduced carbon emissions or expanded levels of diversity on the board of directors, to the financial terms of the loan. When sustainability targets are met, the interest rate of the loan is reduced. These loans tie improved ESG performance directly to improved financial performance. At the end of the third quarter of 2019, sustainability-linked loans totaled $71.3 billion, more than double the $32 billion in deals raised during the same period of 2018.[8]

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[1] Barth, Mary E. and Konchitchki, Yaniv and Landsman, Wayne R., Cost of Capital and Earnings Transparency (January 2013). Journal of Accounting & Economics (JAE), Forthcoming, Stanford University Graduate School of Business Research Paper No. 2015, Rock Center for Corporate Governance at Stanford University Working Paper No. 48, *Available at* SSRN: https://ssrn.com/abstract=1348245; Leuz, Christian and Schrand, Catherine M., Disclosure and the Cost of Capital: Evidence from Firms' Response to the Enron Shock (March 2009). Chicago Booth School of Business Research Paper No. 08-26, *Available at* SSRN: https://ssrn.com/abstract=1319646.

[2] Khan, Mozaffar and Serafeim, George and Yoon, Aaron, Corporate Sustainability: First Evidence on Materiality (November 9, 2016). The Accounting Review, Vol. 91, No. 6, pp. 1697-1724., *Available at* SSRN: https://ssrn.com/abstract=2575912.

[3] Russell Investments, "Materiality matters: Targeting the ESG issues that can impact performance – the material ESG score," *available at* https://russellinvestments.com/-/media/files/us/insights/institutions/governance/materiality-matters.pdf?la=en.

[4] TruValue Labs, "New Alpha from ESG2.0 Factors – U.S. Large Cap," *available at* https://www.truvaluelabs.com/wp-content/uploads/2017/11/Sum_PerfTest_SP500.pdf.

[5] BlackRock, "A Fundamental Reshaping of Finance," *available at* https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

[6] State Street Global Advisors, "CEO's Letter on our 2020 Proxy Voting Agenda," *available at* https://www.ssga.com/us/en/institutional/ic/insights/informing-better-decisions-with-esg.

[7] Sustainability Linked Loan Principles (SLLP). *Available at* https://www.lsta.org/content/sustainability-linked-loan-principles-sllp/.

[8] Rhea Wessel, "Rising Tide For Sustainability-Linked Loans," Global Finance, March 06, 2020. *Available at* https://www.gfmag.com/magazine/march-2020/rising-tide-sustainability-linked-loans.

Money flows into sustainable funds may cause the constituents of these funds to outperform

Flows into investment products with an environmental, social, or governance focus are topping earlier records, gathering over $15 billion in just the first six months of 2020.[9] These flows are considered to be part of a decades-long trend.[10] BlackRock theorizes that these long-term flows will have the effect of inflating asset prices of ESG funds, and the securities preferred by these funds. Thus, ESG funds may see decades of outperformance relative to conventional funds.

Anticipation of risks can help companies to avoid or mitigate disastrous impacts on their securities prices

Earlier this month, the U.K. fashion brand Boohoo saw its stock price drop precipitously following allegations of unfair labor practices.[11] "In our view, part of the problem Boohoo has had through these accusations is that it does not appear to have full transparency on all of its supply chain, particularly its Tier 2 suppliers," said a Bank of America analyst comment. Unfortunately, stock price risks like these, related to insufficient corporate attention to social license to operate, are all too common.[12] ExxonMobil has been a horrible stock; in the last five years its price has dropped by 48%, compared to a 52% rise in the S&P 500. Much of the drop is attributable to a poor supply/demand balance for oil and gas, but Exxon has also significantly underperformed its U.S. oil major peers. Exxon has underperformed due to its greater exposure to regulatory and legal risk stemming from its poor climate disclosure and its lobbying efforts related to climate denial. In each case, ESG analysis could help beneficiaries avoid these pitfalls.

If the Department wishes to impose restrictions on sustainable or ESG investing, it should get its facts straight. Our desire to have sustainable investment options for our QDIA would enhance our beneficiaries' returns, not damage them. The Department has provided zero evidence to show that sustainable investing damages beneficiaries' risk-adjusted returns.

The Department has adopted an antiquated view of the relationship between sustainable investing and non-pecuniary motives

The Department seems to assume that all ESG investing involves a non-pecuniary motive. But a great deal of ESG investing takes place solely to derive pecuniary benefits. The Department appears confused about the variety of ESG strategies. The 2018 Global Sustainable Investment Review classifies ESG strategies into negative, positive and norms-based screening; ESG integration, thematic investing, and impact investing.[13] ESG integration, "the systematic and explicit inclusion by investment managers of environmental, social and governance factors into financial analysis," is the dominant variety in the U.S.

Negative screening, which may or may not incorporate non-pecuniary goals, was an original ESG strategy that grew out of the divestment movement. But negative screening is also undertaken with pecuniary benefits in

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[9] Andrea Riquier, "Sustainable-investing flows have smashed records in 2020. What's going on?" MarketWatch, July 16, 2020. *Available at* https://www.marketwatch.com/story/sustainable-investing-flows-have-smashed-all-records-in-2020-whats-going-on-2020-07-07.

[10] Jean Boivin, "Sustainable investing: Think long term, act now," BlackRock Blog, March 31, 2020. *Available at* https://www.blackrockblog.com/2020/03/31/sustainable-investing-think-long-term-act-now/.

[11] Poppy Wood, "Boohoo shares continue downward spiral amid sales slump warnings," City A.M., 14 July 2020, *available at* https://www.cityam.com/boohoo-shares-continue-downward-spiral-amid-sales-slump-warnings/.

[12] Maxx Chatsko, "Here's Why Tahoe Resources Dropped as Much as 25.9% Today," The Motley Fool, September 4, 2018. *Available at* https://www.fool.com/investing/2018/09/04/heres-why-tahoe-resources-dropped-as-much-as-259-t.aspx.

[13] Global Sustainable Investment Alliance, 2018 GLOBAL SUSTAINABLE INVESTMENT REVIEW. *Available at* https://www.ussif.org/store_download.asp?key=ccDzL2NjXsPsZ52RV30B5KDLJHtt2C.

mind. When California State Teachers Retirement and CalPERS both divested their tobacco holdings in 2000, it was on the basis that regulatory and legal risks to the industry were unacceptably high.[14] The University of California made its 2019 decision to divest from fossil fuels for exactly the same reason.[15] ESG integration, the dominant form of sustainable investing in the U.S., is explicitly concerned with pecuniary benefits. The Department in this proposed rule has tarred all forms of sustainable investing with the same brush, and has provided no explanation, nor justification.

The Administrative Procedure Act prohibits regulations that are “unsupported by substantial evidence” or “unwarranted by the facts.”[16] The proposed rule implies, without evidence or facts, that all ESG investing involves non-pecuniary motives. In addition the Department has performed zero analysis to refute our contention that ESG integration provides beneficiaries with enhanced, not diminished, returns. In this regard the DOL will continue the Trump administration’s dismal record of promulgating regulations that do not survive judicial review.[17] The proposed rule should be withdrawn.

Sincerely,

Dan Chu, Executive Director

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[14] Julie Tamaki, “Fund To Debate Tobacco Holdings,” Los Angeles Times, April 5, 2000, *available at* HTTPS://WWW.LATIMES.COM/ARCHIVES/LA-XPM-2000-APR-05-MN-16182-STORY.HTML; Associated Press, “CalPERS Votes To Sell Tobacco Stock,” October 17, 2000. Available at https://www.washingtonpost.com/wp-srv/aponline/20001017/aponline084411_000.htm.

[15] Umair Irfan, “The University of California system is ending its investment in fossil fuels,” Vox, Sep 18, 2019. *Available at* https://www.vox.com/2019/9/18/20872112/university-california-divestment-fossil-fuel-climate-change.

[16] Todd Garvey, “A Brief Overview of Rulemaking and Judicial Review,” Congressional Research Service, March 27, 2017, at 13. *Available at* https://fas.org/sgp/crs/misc/R41546.pdf.

[17] The Institute for Policy Integrity, “Roundup: Trump-Era Agency Policy in the Courts,” *available at* https://policyintegrity.org/?ACT=69&path=trump-court-roundup%2Fpdf&size=letter&orientation=portrait&key=deregulation-roundup&attachment=1&compress=1&filename=.

2101 Webster Street, Suite 1250, Oakland, CA 94612 • [T] (415) 995-1780 • [F] (510) 208-3140 • sierraclubfoundation.org