July 29, 2020

Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, NW
Room N-5655
Washington, DC 20210
ATTN: Financial Factors in Selecting Plan Investments, Proposed Regulation

RE: RIN 1210-AB95

Dear Assistant Secretary Wilson:

This letter is to oppose the Department of Labor's proposed changes in the selection of ESG investments by fiduciaries under the Employment Retirement Income Security Act (ERISA), as detailed in RIN 1210-AB95. The revisions suggested in RIN 1210-AB95 would discourage fiduciaries from impartially evaluating ESG investments—which typically provide superior or equivalent financial performance versus matched conventional alternatives—while steering them toward conventional investments that could pose greater risks of financial loss due to technological and regulatory changes and shifting consumer preferences. By contrast, maintaining the current Department of Labor regulatory framework would permit retirement plans to even-handedly evaluate non-ESG and ESG investments with a focus on financial return, risk and diversification.

We write as career fiduciary, investment, regulatory and legal professionals in the areas of commercial real estate, infrastructure, energy efficiency, affordable housing and environment. Each of us has decades of professional experience in our areas of specialization, collectively encompassing substantial expertise in ESG and conventional investing for pension plan beneficiaries and institutional investors.

RIN 1210-AB95 ignores the consensus of recent industry and academic research that ESG investments perform at least as favorably and **frequently more favorably** than their conventional equivalents. Further, conventional investments are far more likely to become "stranded", i.e. to rapidly lose economic value due to changing technologies, regulatory requirements and/or consumer preferences.

<u>ESG investments and funds frequently outperform their conventional equivalents</u>. That ESG investments and funds tend to outperform their conventional counterparts is a finding that has been replicated robustly in industry and academic studies, including research conducted for the Department of Labor.

Morningstar. In data published in 2020, Morningstar found that sustainable funds outperformed their conventional peers for the one-year, three-year and five-year periods ending December 31, 2019. For 2019, "(t)he returns of 35% of sustainable funds placed in the top quartile of their respective [investment] categories, and nearly two thirds finished in the top two quartiles. By contrast, the returns of only 14% of sustainable funds placed in the bottom quartile, and only about one third placed in the bottom half."[1] Similar results were observed for the trailing three-year and five-year periods,[2] indicating that superior results for sustainable funds are lasting, rather than ephemeral.

Importantly, Morningstar found that sustainable funds have held their value over diverse market conditions. From 2015-2019, "sustainable funds have done well in both up and down markets relative to their conventional peers. When markets were flat (2015) or down (2018), the returns of 57% and 63% of sustainable funds placed in the top half of their categories. When markets were up in 2016, 2017, and 2019, the returns of 55%, 54%, and 65% of sustainable funds placed in the top half of their categories."[3] Investments that deliver consistently positive performance under varied market conditions are particularly beneficial for pension plan participants and beneficiaries.

Superior results for sustainable and ESG funds relative to their conventional peers have continued through the first half of 2020, according to Morningstar. As of June 30, 2020, "72% of sustainable equity funds rank in the top halves of their Morningstar (c)ategories and all 26 ESG (environmental, social, and governance) index funds have outperformed their conventional index-fund counterparts."[4] As this suggests, sustainable equity and ESG funds have outperformed their conventional peers through a period of severe market volatility.

U.S. Government Accountability Office. In a May 2018 study, the U.S. Government Accountability Office (GAO) reviewed 11 peer-reviewed studies conducted from 2012 to 2017, nine of which incorporated 1,288 performance scenarios evaluating U.S. ESG investments. Eighty-eight percent of the scenarios reported positive or neutral impacts on financial returns from the use of ESG information, as compared to otherwise similar investments. In addition, GAO reviewed the findings of a 2015 meta-analysis of over 2,000 empirical studies of investment performance, confirming that 90 percent reported "a neutral, positive or mixed (i.e. non-negative) relationship between

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[1] Jon Hale, "U.S. ESG Funds Outperformed Conventional Funds in 2019," Morningstar.com, April 16, 2020, https://www.morningstar.com/articles/973590/us-esg-funds-outperformed-conventional-funds-in-2019

[2] Ibid.

[3] Ibid.

[4] Jon Hale, "Sustainable Stock Funds Held Their Own in Second-Quarter Rally," Morningstar.com, July 8, 2020, https://www.morningstar.com/articles/991091/sustainable-stock-funds-held-their-own-in-second-quarter-rally

incorporating ESG factors and financial performance."[5] In sum, GAO found that "the body of published research suggests that such [ESG] factors can be used in investment management without sacrificing financial performance and potentially improving it."[6]

Study for the Department of Labor. In a December 2017 study completed for the Department of Labor, Summit Consulting, LLC found that "empirical research suggests that ESG investments perform at least as well as conventional investments."[7] Summit's review of six empirical studies performed between 2006 and 2016 concluded that "incorporating ESG factors into investments generally produced investment performances on par with or better than non-ESG investments."[8] 2007 and 20015 meta-analyses reviewed by Summit "found that ESG factors do not have a negative effect on investment performances compared with non-ESG investments," and five meta-analyses conducted between 2009 and 2016 found that ESG factors were positively correlated with better investment performance."[9]

Conventional Assets are More Likely to Become "Stranded" than ESG Investments. "Stranded" assets are assets that rapidly lose market value due to changing technology, regulations and consumer preferences. The evidence indicates that conventional assets, especially in the real estate and energy sectors, are more likely to become stranded than ESG investments in these sectors.

Real Estate Markets. Since the early 2000s, sustainable/ESG real estate investments have consumed a growing share of institutional investment, relative to conventional investments. In the commercial real estate markets (defined as commercial and multi-family properties), institutional investment has become largely synonymous with sustainable investment, due to the heightened occupancies, operating cash flows and investment values associated with energy- and water-efficient building components, including but not limited to roofs, construction materials, insulation, window systems, plumbing, lighting, heating, ventilating and air conditioning equipment and other building mechanical elements.

Tenants have shown a marked preference for green design features and building finishes that do not emit volatile organic compounds, helping to drive faster leasing, higher occupancy levels and superior tenant retention; such design features and finishes are routinely used in sustainable/ESG real estate

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[5] Government Accountability Office, *Retirement Plan Investing: Clearer Information on Environmental, Social, and Governance Factors Would be Helpful*, GAO 18-398, May 2018, pp.2, 7-8. https://www.gao.gov/products/GAO-18-398

[6] Ibid, p. 43.

[7] Ogechukwu Ezeokoli, et. al., Summit Consulting, LLC, *ESG Investment Tools—Review of the Current Field*, U.S. Department of Labor, December 2017, p.13, https://www.dol.gov/sites/dolgov/files/OASP/legacy/files/ESG-Investment-Tools-Review-of-the-Current-Field.pdf

[8] Ibid., p.14.

[9] Ibid., p.14.

investments. Finally, sustainable/ESG real estate investments are more likely to weather the growing number of state, local and federal mandates requiring building energy-efficiency, green certification, or the use of sustainable construction standards. As a result, sustainable real estate is more likely to be preferred and conventional real estate devalued by institutional investors.

Available research confirms that sustainable/ESG real estate typically produces higher investment values than conventional properties and that conventional properties are more likely to become stranded due to obsolescence and regulatory changes. According to a 2020 meta-analysis of over 70 peer-reviewed academic studies published from 2008-2019, "sustainability is a significant success factor for real estate investors. Almost all the reviewed studies found that [green] certification had positive effects on properties' cash flows and values….Regular buildings are those that suffer faster obsolescence and tightening regulations, which further increases the polarization between sustainable and non-sustainable assets."[10]

Energy Markets. According to the Inter-American Development Bank (IADB), climate change concerns, tightening environmental regulations, falling solar and wind energy costs, and rising litigation risks indicate that conventional fossil fuels have an increasing risk of becoming stranded.[11] Estimates cited by the IADB found that 60 to 80 percent of publicly-traded fossil fuel reserves could be considered unburnable, potentially costing the industry $28 trillion in revenues by the mid-2030s.[12]

Can unanticipated market events lead to the stranding of assets? A recent German study found that unexpected regulatory changes adversely affecting fossil fuel companies produced at least 20% in investment losses over five days. The German case demonstrates that seasoned investors in fossil fuels can be surprised by unexpected regulatory outcomes and that "stranded asset risk is relevant for the energy sector and beyond," producing "risk not just for the obviously affected energy industry facing sunk costs," but "also for financial institutions… especially about a sudden re-pricing of assets."[13]

Conclusions. As demonstrated by the foregoing material, ESG investments deliver a financial performance that is at least as favorable as and frequently more favorable than non-ESG investments. In addition, ESG investments in the commercial real estate and energy sectors frequently offer

[10] Niina Leskinen, Jussi Vimpari , Seppo Junilla,"A Review of the Impact of Green Building Certification on the Cash Flows and Valuations of Commercial Properties," *Sustainability*, March 31, 2020, pp. 14, 15, https://res.mdpi.com/d_attachment/sustainability/sustainability-12-02729/article_deploy/sustainability-12-02729-v2.pdf

[11] Caldecott, et. al., *Stranded Assets: A Climate Risk Challenge*, Inter-American Development Bank, 2016, p.5, https://lpdd.org/wp-content/uploads/2020/03/Stranded-Assets-A-Climate-Risk-Challenge.pdf

[12] Ibid., p. x.

[13] Suphi Sen, Marie-Theres von Schickfus, "**Climate Policy, Stranded Assets, and Investors' Expectations,"** *Journal of Environmental Economics and Management*, Volume 100, March 2020, unpaginated, https://www.sciencedirect.com/science/article/pii/S0095069618307083

reduced risk and/or heightened investment returns relative to conventional equivalents, due to superior technologies, declining costs, shifting consumer preferences and regulatory changes. In the energy industry, investors in fossil fuel assets are especially at risk of facing destabilizing price declines, particularly in the face of unanticipated adverse regulatory decisions.

Against this backdrop, it is important to allow retirement plan fiduciaries to fully consider the opportunities and risks of both ESG and non-ESG investments on a level playing field. By requiring heightened scrutiny and justification for investment in ESG assets, RIN 1210-AB95 steers plan fiduciaries to conventional instruments, preventing the full and unfettered exercise of impartial due diligence. By contrast, retaining the Department of Labor's current, well-tested regulatory framework would optimize investment outcomes for the participants and beneficiaries of retirement plans.

Sincerely,

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