

North American COAL

Rebecca McGrew, RPG
Manager, Environmental and Regulatory Affairs

Telephone: 972-448-5470
Email: rebecca.mcgreg@nacco.com

December 13, 2021

VIA Electronic Submission - RIN 1210-AC03

Office of Regulations and Interpretations
Employee Benefits Security Administration, Room N-5655
US Department of Labor
200 Constitution Avenue NW
Washington, D.C. 20210

Re: Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights
Comments of The North American Coal Corporation

Dear Sir or Madam:

The North American Coal Corporation (“NAC”) appreciates the opportunity to furnish comments on behalf of our coal mining operations as well as our subsidiaries, Catapult Mineral Partners and North American Mining. These comments are submitted in response to the U.S. Department of Labor’s (“DOL”) proposed rule amending the investment duties regulation under Title I of the Employee Retirement Income Security Act (“ERISA”). NAC is the plan administrator of a 401(k) plan with approximately \$750 million in plan assets and four defined benefit pension plans with approximately \$283 million, collectively, in plan assets.

Background

Title I of the Employee Retirement Income Security Act of 1974 (ERISA) establishes minimum standards that govern the operation of private-sector employee benefit plans, including fiduciary responsibility rules. Section 404 of ERISA, in part, requires that plan fiduciaries act prudently and diversify plan investments so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.¹ The DOL proposes amendments to clarify the application of ERISA’s fiduciary duties of prudence and loyalty to selecting investments and investment courses of action, including selecting qualified default investment alternatives, exercising shareholder rights, such as proxy voting, and the use of written proxy voting policies and guidelines.² The proposed amendments roll back the November 2020 revisions that generally require plan fiduciaries to select investments and investment courses of action based solely on consideration of pecuniary factors. Rather than maintaining this straightforward, well-established approach, the DOL’s

¹ 29 U.S.C. 1104.

² 86 Fed. Reg. 57272 (October 14, 2021)

proposal would encourage ERISA fiduciaries to navigate a new frontier, making investment decisions that reflect considerations of climate change and other environmental, social, or governance (“ESG”) considerations that have perceived benefits apart from investment return.³

ESG Frameworks & Scoring

ESG, as a qualifying investment consideration, is too new and unproven to be deemed prudent.⁴ In fact, concern over ESG has only been around for approximately 10 years.⁵ ESG frameworks are designed to gauge a company’s commitments to environmental, social, and governance principles but, in the United States, the ESG system is entirely extra-regulatory. These private sector ESG frameworks are designed and maintained by third parties with no industry-wide standard governing how companies respond or disclose compliance, and no ability for an impacted entity to engage in framework development vis-à-vis the Administrative Procedure Act. In fact, whether a company responds or not is entirely voluntary which can lead to artificially low or absent ESG ratings from otherwise financially sound companies.

It is reported that “ESG ratings providers play an increasingly important role in the investment process by providing their assessment of companies across various ESG metrics.”⁶ ESG rating providers are third parties that in some cases charge fees to disclose how a company’s score has been generated and/or provide services to rated companies to improve said score. Finally, it has been reported that “the quality of ESG ratings data can be deficient due to a lack of coverage and a dependence on self-reporting”.⁷ As a result, it is not surprising that “greenwashing” is a significant problem as exemplified by the fact the Global Sustainable Investment Alliance erased \$2 trillion from the European market for sustainable investments after anti-greenwashing rules were introduced in March by the European Union.⁸

Companies that don’t engage in greenwashing or ones that have opted not to engage in an extra-regulatory process are likely scored lower than companies that do. If the ERISA rule is amended to allow plan fiduciaries to make ESG-based investment decisions, fiduciaries may be disinclined to invest in certain companies even though strict adherence to pecuniary factors would dictate otherwise.

³ Id.

⁴ Bradford Cornell and Aswath Damodaran, Valuing ESG: Doing Good or Sounding Good? (March 20, 2020) available at <https://ssrn.com/abstract=3557432> at 13.

⁵ Id.

⁶ Li and Polychronopoulos, 2020, What a difference an ESG ratings provider makes; <https://www.researchaffiliates.com/documents/770-what-a-difference-an-esg-ratings-provider-makes.pdf>

⁷ Id.

⁸ <https://www.bloomberg.com/news/articles/2021-09-01/regulatory-scrutiny-of-esg-greenwashing-is-intensifying> (last visited 12/7/2021)

ESG factors & fallacy of higher returns

While the DOL purports investments predicated on ESG factors may yield higher returns, the Wall Street Journal (WSJ) has reported that “many positive ESG studies confuse correlation with causation. Some ESG funds have recently performed better than broader stock indexes because they are weighted heavily toward Big Tech companies whose stock values have soared. But these funds may also carry more financial risk.”⁹ Cornell and Damodaran report “the evidence that markets reward companies for being ‘good’ is weak to non-existent, which can either be taken to mean that markets are rationally assessing ESG actions and finding that they have little effect on value or that markets are short sighted and are not incorporating the long-term value increases associated with being more socially conscious.”¹⁰ For these reasons, NAC believes DOL is interjecting unnecessary risk by allowing ERISA investing based on non-pecuniary factors (including ESG).

DOL has justified the inclusion of ESG investments in the proposed regulation because these revisions reflect the views of stakeholders.¹¹ It should be noted however that many of the stakeholders noted by the DOL stand to gain financially should the final rule explicitly permit ESG investing. According to Morningstar, the asset-weighted average expense ratio of U.S. “sustainable” funds was 0.61% in 2020 compared to 0.41% for all open-ended mutual and exchange-traded funds and 0.12% for passive funds.¹² According to Cornell and Domadaran, “[t]he potential to make money on ESG for consultants, bankers and investment managers has made them cheerleaders for the concept, with claims of the payoffs based on research that is ambiguous and inconclusive”.¹³

Finally, NAC highlights JB Heaton’s work that questions a crucial premise underlying climate-themed investment:

Efforts to mitigate the harmful effects of climate change will push the economy away from one with high-carbon intensity to one with low-carbon intensity, which in turn will reward investors in low-carbon, or green, assets and punish investors in high-carbon, or brown, assets. By investing in green assets and divesting from brown assets, the premise promises that investors might achieve the best of all investment outcomes: doing well by doing good.

⁹ <https://www.wsj.com/articles/your-new-woke-401-k-retirement-savings-esg-erisa-biden-administration-department-of-labor-proposal-11634753095> (last accessed 12/7/2021)

¹⁰ Bradford Cornell and Aswath Damodaran, Valuing ESG: Doing Good or Sounding Good? (March 20, 2020) available at <https://ssrn.com/abstract=3557432>

¹¹ 86 Fed. Reg. 57275, 57277, 57279 and 57280

¹² Rebecca Moore, Morningstar Finds ESG Funds Are More Expensive Than Conventional Funds (Oct. 26, 2021). <https://www.planadviser.com/morningstar-finds-esg-funds-expensive-conventional-funds>; <https://www.wsj.com/articles/your-new-woke-401-k-retirement-savings-esg-erisa-biden-administration-department-of-labor-proposal-11634753095> (last accessed 12/7/2021).

¹³ Bradford Cornell and Aswath Damodaran, Valuing ESG: Doing Good or Sounding Good? (March 20, 2020) available at <https://ssrn.com/abstract=3557432>

Unfortunately, the premise may be wrong. ERISA fiduciaries must consider that possibility, even under the proposed rule.¹⁴

The DOL states in the proposed rule that a prudent ESG investor may favor “a shift from carbon-intensive investments.”¹⁵ It should be noted however, that had an ERISA-fiduciary acted on this advice published in the Federal Register they would have done a grave disservice to the plan beneficiaries as fossil fuel stocks have outperformed other stocks.¹⁶ In the words of the United States Court of Appeals for the Fifth Circuit Court, “Good faith does not provide a defense to a claim of a breach of these fiduciary duties; a pure heart and an empty head are not enough.”¹⁷

ESG Factors Should Not be Required Factors in Reviewing an Investment Option

In describing factors that a fiduciary may consider in selecting investments or investment courses of action, the proposed rule may be interpreted to require consideration of ESG factors. Specifically, section (b)(2)(ii)(C) of the proposed rule states that consideration of a fund’s projected returns “may often require an evaluation of the economic effects of climate change and other environmental, social, or governance factors on the particular investment or investment course of action.” We believe this language puts an undue weight on specific factors, namely ESG factors, that a fiduciary must consider in selecting investments or investment courses of action, where there are far more salient fundamental investment factors to consider. When Congress enacted ERISA, it left the decision of which factors the fiduciary would consider in making investment decisions up to the fiduciary, provided the fiduciary met its duties of prudence and loyalty. Congress did not provide that certain factors must be considered when making such decisions, nor should the DOL.

Proxy Voting

According to the DOL, “Voting proxies are a crucial lever in ensuring that shareholders’ interests, as the company’s owners, are protected. Moreover, abstaining from a vote is not a neutral act” since it “could determine whether a particular matter or proposal is approved.”¹⁸ Many small pension plans abstain from proxy votes because performing the required due diligence would be inordinately expensive which DOL proposes to solve by explicitly recommending reliance on “proxy advisors/managers that act on behalf of large aggregates of investors”.¹⁹ As noted above, proxy advisors that rate companies on ESG factors often also provide ESG counseling to rated companies, a clear conflict of interests. It is surprising the DOL

¹⁴ <https://www.law360.com/articles/1432133/dol-s-proposed-rule-doesn-t-make-esg-investment-risk-free> (last visited 12/7/21)

¹⁵ 86 Fed. Reg. 57277

¹⁶ Jeff Sommer, The Planet Is Warming, but Coal Is on Fire, THE NEW YORK TIMES (Oct. 24, 2021); Amrith Ramkumar, Climate-Focused Investors Miss Oil-and-Gas Rally, THE WALL STREET JOURNAL (Oct. 25, 2021)

¹⁷ Donovan v. Cunningham, 716 F.2d 1455, 1467 (5th Cir.1983)

¹⁸ 86 Fed. Reg. 57281

¹⁹ Id.

would encourage these advisors in this conflict and further encourage fiduciaries to take their conflicted advise.

Conclusions

In the words of J.B. Heaton:

Investment fiduciaries, including ERISA fiduciaries, must remember investment fundamentals. Contrary to the promises of climate-themed investment sellers, simple financial analysis suggests that brown firms may outperform green firms in many future scenarios, whether the low-carbon transition succeeds or fails. Prominent institutional investors argue that climate transition — moving from a high-carbon economy to a low-carbon economy — creates investment opportunities in green assets and casts doubt on the viability of brown assets. Unfortunately, the premise may be wrong. ERISA fiduciaries must consider that possibility, even under the proposed rule.²⁰

NAC believes the proposed regulations tacitly endorse and encourage fiduciaries to rely on an extra-regulatory ESG system of reporting and scoring that is not consistent or robust enough to support ERISA's fiduciary duties. Over reliance on the current ESG system could weaken the duties of prudence and loyalty and thereby jeopardize the retirement assets of America's workers and retirees. The interests of America's workers trump the special interest supported by the DOL's proposed rule.

Sincerely,

The North American Coal Corporation

Rebecca McGrew

Rebecca McGrew
Manager, Environmental and Regulatory Affairs

²⁰ <https://www.law360.com/articles/1432133/dol-s-proposed-rule-doesn-t-make-esg-investment-risk-free> (last accessed 12/7/21)