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Insight
INVESTMENT

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INFORMATION FOR EMPLOYEE BENEFITS SECURITY ADMINISTRATION ON CLIMATE-RELATED FINANCIAL RISK

THE EMPLOYEE BENEFITS SECURITY ADMINISTRATION (EBSA) HAS ISSUED A REQUEST FOR INFORMATION RELATING TO RETIREMENT SAVINGS AND CLIMATE-RELATED FINANCIAL RISK. THIS DOCUMENT OUTLINES INSIGHT INVESTMENT'S ANSWERS TO SELECTED QUESTIONS FROM THE AGENCY.

Insight Investment focuses on maximizing the certainty of our clients achieving their targeted investment objectives. Our client base includes both defined benefit and defined contribution retirement plans and we seek to achieve our clients' objectives by investing prudently in portfolios largely consisting of fixed income assets. In this document, we therefore focus on fixed income.

Key points we wish to highlight in our response include the following:

- **Gaps in climate-related data need to be addressed:** There remain significant gaps in climate-related data. Before requiring retirement plans to report on the climate risks within their investment portfolios, the gaps in issuer data must be addressed.
- **Some asset classes face challenges regarding climate-related data:** Climate-related data will vary based on equity relative to fixed income and some investment types (such as private debt and asset-backed securities) bear significant data challenges, which any reporting requirements will need to take into account.
- **Avoiding unintended consequences:** Determining whether a risk is material and relevant is, in many cases, a qualitative judgement, and the future impact of climate change for individual issuers can be difficult to discern. We therefore caution that prescriptive requirements for retirement plans to report on predefined climate-related metrics, unless they are given sufficient context, may lead to unintended consequences from viewing such data in isolation.
- **Proposals for issuer disclosures should be implemented first:** We note that other proposals relating to ESG and climate risk disclosures are also in progress; most notably, the proposed rules on climate-related disclosures from the Securities and Exchange Commission (SEC)¹. We believe it would be logical for proposed disclosures for corporates (thereby including equity and bond issuers) to be finalized before mandated disclosures are put in place for other entities.

GENERAL

1. Please provide your views on how EBSA should address and implement the action items set forth for EBSA in Executive Order 14030 on Climate-Related Financial Risk. Specifically, what agency actions can be taken under ERISA, FERSA, and any other relevant laws to protect the lifesavings and pensions of U.S. workers and families from the threats of climate-related financial risk?

It is necessary to understand a problem to address it effectively, and to measure one's success or failure. We therefore welcome the questions in EBSA's request for information that focus on data-gathering regarding climate risk.

In principle, we would encourage retirement plan sponsors to better understand the climate risks their investments may face. In our experience, most fixed income issuers within our investment universe are susceptible to the consequences of climate change through a wide range of factors, including potential impacts on supply chains, regulatory uncertainty and resource scarcity. The financial risks that arise from such factors are many, with varying implications for different sectors and financial instruments. We endorse the efforts of the

¹ [Enhancement and Standardization of Climate-Related Disclosures](#), March 21, 2022, SEC.

Task Force on Climate-related Financial Disclosures (TCFD)², which has set out recommendations for disclosing clear, comparable and consistent information about the risks and opportunities presented by climate change.

However, while data is typically available for larger equity and corporate bond issuers and progress is being made by bodies such as the TCFD, there are still gaps in data. **Before requiring plans to report on the climate risks within their investment portfolios, the gaps in issuer data must be addressed.** This may be achieved in part through other proposed regulations in development such as the proposed rules on climate-related disclosures from the SEC. This would ensure alignment with other rules and encourage consistency and comparability.

It is critical to note that aside from larger US equity and corporate bond issuers, which account for a meaningful share of US retirement plans' asset allocations and have imperfect data, **other asset classes bear even more significant data challenges.**

We believe any obligation or requirement to report on portfolio climate risks should reflect the availability and quality of relevant data. We provide an overview of some of the issues by asset class below:

- **Government bonds and supranational issued instruments:** Core climate-related metrics are theoretically possible for government bonds and supranational instruments, but there can be issues with double counting (e.g. for portfolios with sovereign and corporate exposure) and the scope of what accounts for the entities' emissions must be agreed (e.g. -based production versus consumption-based).
- **Private debt and loan securities:** Currently there is no established infrastructure for data collection from issuers of private debt. At Insight we look to fill this data gap with questionnaires and direct engagement, but our dialogues show that some smaller companies do not have the infrastructure to supply the requisite information. It may be necessary to consider exempting securities based on issuer size.
- **Newly issued asset-backed securities (ABS):** There can sometimes be data available for these securities, but not always, and in some cases it will not be relevant (e.g. credit card ABS). We hope the availability of data will improve over time so that new deals provide the required information. Insight is already working on initiatives aimed at encouraging these to be developed at an industry level³.
- **Legacy ABS:** These have data gaps, and it is not practically possible to fill these gaps as there is no corporate entity to provide the data. As noted above for newly issued ABS, for some ABS these data may not be relevant.
- **Securities issued in jurisdictions with no climate reporting regime:** Not all regimes will have climate reporting regimes and therefore some flexibility will be needed to cater for circumstances where the issuer of a security does not report required metrics.
- **Currency instruments:** We do not believe climate-related metrics are relevant or applicable for currency instruments.
- **Certain derivatives:** There are challenges to employing climate-related metrics with respect to derivatives instruments. Derivatives often have no issuer linked to them to determine the metrics. While it could be argued that metrics should be reported for derivatives instruments linked to a corporate (e.g. credit default swaps or equity derivatives), holders of derivatives do not have any direct ownership or influence on the company, and there is potential for manipulation of metrics at a portfolio level where negative derivative positions are seen as offsetting metrics elsewhere. We therefore believe there would be significant questions to answer as to whether derivatives should be in scope, and how they should be treated.

2. Executive Order 14030 uses the phrase “climate-related financial risk” to encompass a wide variety of risks under two broad categories: physical risks and transition risks. What are the most significant climate-related financial risks to retirement savings and why?

For many retirement plans that invest substantially in high quality fixed income, declines in the value of fixed income holdings can have a material impact on their participants' retirement security. Climate-related financial risks can affect retirement savings to the extent they may affect the downgrade and/or default risk of an issuer, a risk that currently exists in the market as rating agencies increasingly factor climate risk into their rating assessments. Credit rating downgrades affecting a pension plan's assets can cause spread widening and perhaps sales to remain in compliance with guidelines, potentially crystalizing underperformance versus a discount rate that may not directly experience these spread movements. Given climate-related risks can be longer term in nature, longer-term degradation of

² <https://www.fsb-tcfd.org/>

³ [Structured Insights: responsible investment in structured credit](#), October 16, 2021, Insight Investment.

investments as a result of these risks may have an impact even if no downgrade occurs due to spread widening, increasing default risk and general underperformance of the issuer.

Insight seeks to identify material climate change-related risks that could affect the default risk of fixed income issuers. Our assessment aims to highlight physical risks, including the risk of fire, flood, coldwave, heatwave, hurricanes, coastal flooding and water stress; and transition risks, including a range of governance, regulation and operations risks.

It is possible that some plan sponsors may be at higher risk directly from climate change, in essence experiencing the 'double whammy' of a climate event simultaneously causing financial impacts to the pension plan and to the sponsor, when the latter is in a weaker position to address the impacts.

We would emphasize that the future impact of climate change is a 'known unknown', with the specific, granular effects and implications over the long term for individual issuers difficult to discern with confidence.

That said, climate change is a long-term phenomenon, and therefore we expect **climate change-related financial risks to be most significant for longer-term debt in sectors especially sensitive to associated physical and transition risks.**

DATA COLLECTION REGARDING ERISA-COVERED PLANS

3. Should EBSA collect data on climate-related financial risk for plans? If so, please specify with as much precision as possible what information EBSA could and should collect, potential sources of such information, as well as how EBSA should collect it.

We do not believe requiring pension plans to disclose climate-related data is currently appropriate given gaps in available data. We would also highlight that the linkage of such data to financial risk is typically indirect.

However, we believe it is appropriate for plans to collect data related to material and relevant climate-related financial risk within their investment portfolios, as these risks could have an impact on whether they can achieve their objectives.

Determining whether a risk is material and relevant is, in many cases, a qualitative judgement that can be informed through quantitative data. In some cases, it can be argued that specific climate-related metrics are a clear indicator of a relevant and material financial risk for an issuer, and therefore may in turn be a relevant and material financial risk for a pension plan.

Global standards recommending specific metrics are already in development. The TCFD has outlined several metrics including the above⁴, and the recently formed International Sustainability Standards Board (ISSB) is expected to open a global consultation on the topic in 2022⁵.

At a minimum, we believe it may be appropriate for plans to start collecting data on scope 1 and 2 emissions, carbon intensity and exposure to 'brown' industry sectors).

If EBSA does in fact require climate reporting for retirement plans, an effective and efficient approach may be to require plans to report data that entities in which they invest are required to disclose under the new SEC rules. This would ensure alignment with other rules and encourage consistency and comparability.

⁴ For more information on potential climate-related risk metrics, please see [Task Force on Climate-related Financial Disclosures: Guidance on Metrics, Targets, and Transition Plans](#), October 2021.

⁵ [ISSB: Frequently Asked Questions](#)

4. Should EBSA use Form 5500 Annual Return/Report (“Form 5500”) to collect data on climate-related financial risk to pension plans? For example, EBSA could add questions to the Form 5500 to collect data on climate-related financial risks to retirement plans and their service providers. For instance, the Form 5500 could try to collect information about whether and how plan investment policy statements specifically address climate-related financial risk, whether service providers disclose or meet metrics related to such financial risks, and whether and how plans have factored climate-related financial risk into their analysis of individual investments or investment courses of action. Similarly, the Form 5500 could try to collect data on whether, and how, plan fiduciaries voted on proxy proposals involving climate-related financial risk. If you think EBSA should use the Form 5500 to collect this, or similar, information, please specify the data that should be collected, how it should be presented as part of the Form 5500, and how collecting that data or information would help protect the life savings and pensions of U.S. workers and families from the threats of climate-related financial risk.¹⁰

No comment.

5. Other than the Form 5500, are there other methods of collecting data on climate-related financial risks to plans that EBSA should consider? For instance, should the Department conduct an information request/survey on plan sponsor or employee awareness of such risks, and if so, should that information request categorize the information based on plan size, e.g., large plans versus small plans, or segmented in another way?

Yes, we believe other approaches (such as surveys) may be appropriate, given the ongoing development of climate-related metrics, understanding of their links to financial risk, and the rapid development of new metrics and approaches to fill gaps in available data.

However, we note that collecting such data in any form would single out climate risk over other risk factors which may be more relevant and material for a retirement plan.

6. Should administrators of ERISA plans be required to publicly report on the steps they take to manage climate-related financial risk and the results and outcomes of any such steps taken, in a form that is more easily accessible to the public, and timelier, than the Form 5500? If so, what alternative to the Form 5500 could be used for such a report, how should this report be compiled, what should be the contents, and how should it be made available to the public?

No comment.

ERISA FIDUCIARY ISSUES

7. Changes in the financial markets, particularly an increased number of metrics and tools allowing for additional analyses of investments, give ERISA plan fiduciaries more information on which to make decisions on climate-related financial risk factors in evaluating the merits of competing investment choices. Some private sector sources are developing structured ESG research data for evaluating corporate performance. What are the best sources of information for plan fiduciaries to utilize in evaluating such risks with respect to plan investments? Are there difficulties or challenges in obtaining such information or comparing information from different sources? If so, what is the source or sources of those difficulties or challenges, and what are the solutions?

Insight’s climate risk assessment uses inputs from multiple data providers. We believe these data providers offer high quality information directly relevant to climate-related financial risk:

- CDP
- Trucost
- MSCI
- Transition Pathway Initiative
- Science Based Targets initiative

However, each has a different approach and provides different ratings and metrics. It is important to note that the data and ratings are not analogous to credit ratings which are broadly consistent and comparable in terms of approach and usage.

8. Do any guaranteed lifetime income products (e.g., annuities) help individuals efficiently mitigate the effects of at least some climate-related financial risk? If so, what mitigation measures do these products take? Would such products constitute a safe and efficient strategy to transfer climate-related financial risk from the participant/employee to the insurer/guarantor? If so, should EBSA take steps to facilitate the inclusion of these products in ERISA-covered defined contribution plans? If so, what steps should be taken and what products should be considered, and why? Are there climate-focused annuities that plans could offer?

No comment.

FERSA

9. 5 U.S.C. 8438 defines the specific types of investments that are permissible under the TSP. Given the scope of 5 U.S.C. 8438, what specific actions relating to FRTIB's consideration of ESG factors, including climate-related financial risks, when making investment decisions could and should EBSA take, consistent with EBSA's authority and role under FERSA, and why?

No comment.

10. The Executive Director and the members of the FRTIB are TSP fiduciaries, and are subject to the fiduciary responsibility and prohibited transaction provisions set forth at 5 U.S.C. 8477. FERSA requires the Department to, among other things, establish a program to carry out audits to determine the level of compliance with these standards and obligations. Those responsibilities have been delegated to EBSA, which implements a risk-based audit program that identifies risks and vulnerabilities, assesses the likelihood of harm from these risks and vulnerabilities, and considers the magnitude of potential damage associated with the various risks and vulnerabilities. FERSA also provides the Department with specific authority to prescribe regulations to carry out 5 U.S.C. 8477. How can EBSA best conduct an audit program, consistent with its authority and role under FERSA, that identifies and assesses the risks and vulnerabilities posed to TSP by climate change? What types of questions should the audit program answer? What data sources should EBSA use to answer them?

No comment.

11. What policies and practices do managers of sovereign wealth funds or public pensions, in the United States or overseas, follow to help mitigate climate-related financial risks, and are these policies and practices significantly different from the policies and practices of managers of ERISA-covered plans? Which of these policies and practices could the Department or the FRTIB incorporate into their obligations under FERSA?

Insight Investment's clients include institutional investors in the US and around the world, including public pension plans and sovereign wealth funds.

There are few common features in how our clients approach climate-related risks. Some have committed to achieving emissions reduction goals, advocated by initiatives like the [UN-convened Net-Zero Asset Owner Alliance](#); others are considering how to finance environmental initiatives with their portfolios; while others are focused purely on the financial risks arising from climate change, asking their investment managers to incorporate proprietary climate risk ratings in their investment decisions. The most common request from our clients in recent years has been for more information on climate-related risks within their portfolios. This has been driven in part by regulation requiring transparency on relevant metrics.

12. A 2021 GAO Report recommended that FRTIB conduct a rigorous audit of TSP's exposure to climate-related financial risk. What data, if any, should FRTIB collect on TSP's exposure to climate-related financial risk? What types of data, if any, should it collect from asset managers regarding climate-related financial risk?

No comment.

13. What information, if any, should the FRTIB collect on asset managers' policies, including their consideration of climate change and ESG factors in their stewardship and investment decision-making, and how their actual behavior corresponds to their stated policies? How could this data inform FRTIB's own decision-making and management of TSP?

As a baseline, we believe it is informative if an asset manager has committed to support initiatives including the TCFD and Principles for Responsible Investment (PRI)⁶.

We also believe asset managers can offer the following to help investors understand their approach:

- Policies regarding climate change-related risks
- Examples of research on entities, or engagement with them, reflecting consideration of climate change-related risks
- Examples of investment decisions reflecting consideration of climate change-related risks

14. What actions, if any, should the TSP's asset managers, take to incorporate climate-related financial risk, consistent with FERSA's terms and their duty of prudence?

No comment.

15. The TSP's fund offerings rely on passive index investing. Is there evidence that the indices relied upon by the TSP systematically underestimate or overestimate the risks associated with climate change, or that the market fails to appropriately factor in the risks associated with climate change in pricing publicly-traded assets?

No comment.

16. What analysis could FRTIB undertake to inform whether other possible indices may better take into account the risks posed by climate change? What analysis could FRTIB perform to weigh this feature against other characteristics of these indices such as their fees? What actions could FRTIB take to consider climate change and other material ESG factors in directing investment selection decisions for the TSP, consistent with FERSA's statutory requirement that indices be "commonly recognized" and a "reasonably complete representation" of the market?

No comment.

17. Other than investments, are there any incentives that could be offered to encourage more effective incorporation of climate-related financial risks into TSP, using the regulatory authority delegated to the Secretary or other administrative authorities under FERSA?

No comment.

18. Some material suggests that when plan participants know their plan offers ESG options, many will invest in them. See, e.g., ESG Options in 401(k) Plans Could Lead to Higher Contribution Rates According to Schroders Survey, (May 13, 2021), available at <https://www.schroders.com/en/us/private-investor/media-centre/retirement-survey-2021-esg/> (when plan participants know their plan offers ESG options, 90% invest in them). In a 2017 survey of TSP participants, twenty-two percent of respondents said they most want the TSP to offer a broader range of investment options. See Federal Retirement Thrift Investment Board: 2017 Participant Satisfaction Survey, P. 11, fig. 8 (2017) available at <https://www.frtib.gov/ReadingRoom/SurveysPart/TSP-Survey-Results-2017.pdf>. Are there additional data suggesting, measuring, or otherwise indicating whether federal employees' prefer ESG-focused investments?

No comment.

⁶ <https://www.unpri.org/>

MISCELLANEOUS

19. Are there any legal or regulatory impediments that hinder managers of investments held in savings and retirement arrangements not covered by ERISA, such as IRAs, from taking steps to mitigate against climate-related financial risks to those investments? Does the absence of prudence and loyalty obligations with respect to these arrangements leave them vulnerable to climate-related financial risks?

No comment.

20. Should EBSA sponsor and publish research to improve data and analytics that ERISA plan fiduciaries could use to evaluate climate-related financial risks? If so, what research subjects should EBSA sponsor?

Yes. We would encourage efforts to increase understanding of any potentially material risk for retirement plans. Research topics might include how assets perform with reference to their climate change-related disclosures, and the extent to which the risk and return characteristics of different asset classes (such as equities, fixed income and real estate) are sensitive to climate change-related metrics over the short and long term.

21. Is there a need to educate participants, especially those responsible for making their own investment decisions in participant-directed individual account plans, about climate-related financial risks? If yes, what role, if any, should EBSA play in sponsoring and providing such education? In addition, what efforts, if any, should EBSA make to coordinate with the Securities and Exchange Commission on its efforts to inform and protect investors, especially individual investors such as plan participants, from potentially misleading statements about fund adherence to policies that address climate-related financial risk (often referred to as “greenwashing”)?

No comment.

22. Is there a need to educate owners of IRAs about climate-related financial risks? If yes, what role, if any, should EBSA play in assisting the IRS or States (for those having state automatic-IRA arrangements) in sponsoring and providing such education?


No comment.

FIND OUT MORE

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