ICSWG-US Response to the Department of Labor's Climate Change RFI

May 16, 2022

Re: Employee Benefits Security Administration, Department of Labor, "Request for Information on Possible Agency Actions to Protect Life Savings and Pensions from Threats of Climate-Related Financial Risk"

This letter is submitted by The Investment Consultants Sustainability Working Group - United States ("ICSWG-US") in response to the Request for Information on Possible Agency Actions to Protect Life Savings and Pensions from Threats of Climate-Related Financial Risk (the "RFI"). The ICSWG-US would like to thank the Department of Labor (the "DOL") for soliciting input on this important topic; we appreciate the DOL's desire to gather feedback from industry stakeholders.

As background, the ICSWG-US is a collaboration among 17 investment consulting firms, representing more than $33 trillion in assets under advisement. It was established in 2021 to engage with its collective stakeholders and empower asset owners and their ultimate beneficiaries to advance sustainable investment practices across the investment industry. Our market position provides us with a unique perspective due to our ongoing interactions with both plan sponsors and asset managers, as we work collaboratively to evaluate the impact of climate-related financial risks on retirement plan investments and how those risks may be evaluated and mitigated.

The ICSWG-US submits responses to the following RFI questions for the consideration of the DOL:

II. Request for Comments 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?

For investors to assess climate-related financial risks they require public company disclosures, including: scope 1, scope 2, and scope 3 carbon emissions; governance practices; strategies to address climate-related financial risks; and risk management practices. We believe that these disclosures may be outside the scope of EBSA's authority under ERISA and FERSA. However, the SEC's "The Enhancement and Standardization of Climate-Related Disclosures for Investors" proposed rule would require these disclosures. If disclosure is adopted by public companies, this may aid fiduciaries, such as asset managers of investments in ERISA and FERSA plans, to assess climate-related financial risks on behalf of ERISA plan members and beneficiaries.

Disclosure of climate-related financial risks directly to individual ERISA and FERSA plan members and beneficiaries should be consistent with communication of other financial risks.

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?
Climate-related financial risks include both physical risks and transition risks, defined as follows by the International Sustainability Standards Board (ISSB):

Physical Risks: Risks resulting from climate change that can be event-driven (acute) or from longer-term shifts (chronic) in climate patterns. These risks may carry financial implications for entities, such as direct damage to assets, and indirect effects of supply-chain disruption. Entities' financial performance may also be affected by changes in water availability, sourcing and quality; and extreme temperature changes affecting entities' premises, operations, supply chain, transportation needs and employee safety.

Transition Risks: Risks from moving to a lower-carbon economy may entail extensive policy, legal, technology and market changes to address mitigation and adaptation requirements relating to climate change. Depending on the nature, speed and focus of these changes, transition risks may pose varying levels of financial and reputational risk to entities.

As these definitions reveal, the financial materiality and magnitude of either physical or transition climate risks will vary by asset class, by sector and industry within asset classes, and even by individual company and physical asset. Importantly, as the economy transitions, respect for fundamental labor principles and rights are important to the success of an economy wide transition, and could directly affect ERISA pension plan members.

Bodies such as the ISSB are striving to establish global disclosure standards that investors can then analyze and interpret the implications of for their investment portfolio; this type of disclosure would be analyzed by fiduciaries such as asset managers that manage assets on behalf of ERISA and FERSA members and beneficiaries to assess materiality to relevant investments. ICSWG-US supports disclosure standards that are as globally consistent as possible to provide fiduciaries with financially material information on climate-related risks.

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.

EBSA should not collect data on climate-related financial risk for plans at this time. Until there are disclosure standards in place, or a standardized framework and data sources, it would be difficult, if not impossible, to require plan sponsors to report on climate-related financial risks. Challenges that exist currently are: a lack of understanding by plan fiduciaries about climate-

related financial risks; clarity on reliable sources of data; consistency of data; insufficient personnel resources to take on the additional task of reporting; and lack of regulatory guidance.

If EBSA is able to resolve the jurisdictional issues regarding its authorities under ERISA and FERSA, we believe that, once disclosure standards are in place, it could be practical to have plan sponsors report at a plan-level, the aggregated risks identified through standardized disclosures. It would be essential to provide specific guidance to plan fiduciaries on what data to report, how to report it, and where to obtain the data. The disclosure standards would likely start at the individual reporting company level and be aggregated by asset managers into a summary for individual investment options. Once this milestone has been met, the standardized data at the investment option level, it could then be aggregated and summarized at a plan level. Without having the data standardized as it flows through the asset managers/investment options, this would put an additional burden on plan fiduciaries to attempt to make sense of the data or outsource the task to a third party which would be an additional fee. Once the standardized data is aggregated at the plan level, it could then be reported to the EBSA through a separate schedule to the Form 5500, or other filings that are already in place. Without standardization in the process and data, the output will not be meaningful to the EBSA and plan participants/beneficiaries.

A consideration for adding this requirement at the investment product level is that asset managers may need to increase fees due to additional reporting requirements, purchasing data sources, and other administrative work. This increase in fees would then be passed on to the investors.

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.

At this time, we do not believe EBSA should use Form 5500 to collect data on climate-related financial risk to pension plans. Given the lack of standardization, the responses to questions, even just a 'yes' or 'no' on the Form 5500 would be subjective and inconsistent. This could

potentially open the door for differences in interpretation and potential litigation risk as filed Form 5500's are public.

When/if data and disclosures are standardized and can be reported by plans objectively and consistently, we believe reporting to the EBSA could be useful.

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?

ERISA plan sponsors face a wide variety of investment market and economic risks in managing retirement assets. These plan sponsors navigate these risks on an ongoing basis. It does not seem appropriate for EBSA to require reporting on one specific type of risk (climate risk) but not holistically on investment risks, such as credit risk, interest rate risk, liquidity risk, volatility risk, or capital impairment risk. This would appear to be outside of EBSA's scope as a governing body. With regard to a voluntary survey of plan sponsors regarding how this type of risk is treated, this may be helpful for fact-finding. However, we do not support the surveying of plan participants directly, as "climate risk" is but one of a wide variety of investments risks, and it is not traditionally the role of EBSA to educate investors on each individual type of risk in the markets.

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?

We strongly recommend against this sort of requirement. ERISA plan sponsors face a very wide variety of market and economic risks in overseeing retirement assets. It is unclear to us why a single potential risk (climate risk) would warrant special treatment in this regard. Furthermore, we believe this sort of reporting requirement could be overly burdensome to ERISA plans, especially for smaller plans with fewer resources. This requirement may also open up ERISA plans to the risk of litigation.

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?

Currently there are several online resources, tools, and frameworks that are available for plan sponsors and investment managers to access ESG-related data. A few notable sources are: SASB Materiality maps, Sustainable Development Goals (including Targets and Metrics), Science-Based Targets initiative (SBTi), GIIN IRIS +, Impact Measurement Project (IMP), and Frameworks templates developed by the UN PRI. In addition to these resources, and by leveraging the efforts already conducted in Europe such as the EU Taxonomy, SFDR (Sustainable Finance Disclosure Requirement) and TCFD (Task Force for Climate-Related Financial Disclosures), practical insights can be gained to develop frameworks that are appropriate for the US-based plans.

With the increase in climate-related risks from both physical as well as transition risks, there is clearly a need for increasing access to information, standardization, and transparency. Materiality of ESG factors often vary by sector, public vs. private, and by the size of investment firms. While there is increased recognition for ESG disclosures and data, the lack of data standardization remains a key hurdle for its utilization and comparability. In addition, issues such as greenwashing, backward-looking data, self-reporting, self-selecting ESG key performance indicators (KPIs), and time-lag from collection to reporting reduce reliability of data. Finally, costs related to collecting, reporting, and implementing on this data can be a prohibitive factor for mid-small businesses and plans. It can lead to information asymmetry and restricted access. So, while the data needs to be comprehensive and informative, its reporting needs to stay manageable and cost-effective.

The long-term solutions should be to create a strategic and coordinated effort with global regulatory bodies to develop a minimum set of criteria or a common set of metrics that can be tracked and validated by an independent third-party auditor. Such metrics should capture the current data and track commitments towards governance and mitigation of future ESG risks.

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?

The investment impact of climate-related financial risks remains uncertain, as entities including academic institutions, ESG research firms, asset managers, and consultants attempt to assess the forward-looking impact of climate change on both the global economy and on financial markets. There is no evidence to date that guaranteed income products such as annuities offer investors

particular protection to the financial risks of climate change as insurance companies grapple with the same uncertainty as other institutional investors.

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?

In our view, there are no legal or regulatory impediments that hinder managers of investments held in non-ERISA plans from considering climate-related financial risks. The available investment options/vehicles available to non-ERISA plans are generally the same as ERISA plans, with the exception IRAs, 403(b)s and non-qualified plans that have a limited universe of vehicle options. However, plan sponsors of non-ERISA plans may make decisions regarding the investment options utilized by the plan that are not supportive of mitigating climate-related financial risks.

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?

We are supportive of EBSA sponsoring or publishing research of this nature. Specifically, EBSA might consider researching specifics regarding how to define "climate risk" in an investment context and how it might affect investors on a more granular level. As a multi-faceted, multi-generational issue, there is uncertainty about the impacts of climate change on markets, how this may impact asset valuations, and over what time horizon. Balanced and unbiased research may be helpful to shed light on the issue.

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'')?

Yes, participant education on all financial risks, including but not limited to climate-related financial risks, is important to the success of individual's investment decision-making. EBSA should continue to promote clear disclosures, as it already does with the Principle Risk disclosures, that include any reasonably predictable financial risk a participant is exposed to based on the investment policies or objectives of an investment strategy. With that said, we do not believe it is EBSA's role to narrowly focus on any one discrete financial risk over another.

Based on EBSA's mission to develop effective regulations that assist and educate workers, plan sponsors, fiduciaries, and service providers and to vigorously enforce the law, we believe EBSA should coordinate with the Securities and Exchange Commission to inform and protect investors from all forms of misleading statements about an investment manager's adherence to their own investment policies. Due to the fiduciary responsibilities an investment manager knowingly agrees to when accepting a participant's retirement savings dollars, we observe that education, assistance, and regulation should be broadly applied to any misleading activities and not narrowly limited to a single financial factor such as climate-related financial risks or more specifically greenwashing

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?

Education to investors is always needed in terms of risk in investment options, including climate-related financial risks. EBSA could support the IRS and individual States by providing a consistent and reliable source of education at low/no additional cost that is passed on to the underlying investors. For individual IRAs, the investment options utilized are typically higher-cost retail mutual funds. State IRA arrangements have more flexibility to use lower cost institutional mutual funds; however, overall costs are still a concern as many of the covered participants are just starting to build their retirement account. Additionally, having a third party provide the education, as opposed to the investment managers, could also help mitigate any conflicts of interest.

Thank you for your consideration of our responses in forging future regulations. We would welcome the opportunity to discuss our response. You may contact the ICSWG-US at the email below.

Sincerely,

ICSWG-US

About ICSWG-US ***(www.ICSWG-US.org; Contact: info@icswg-us.org)***

The Investment Consultants Sustainable Working Group - United States (ICSWG-US) is a collaboration among investment consulting firms to engage with its collective stakeholders and empower asset owners and their ultimate beneficiaries to advance sustainable investment practices across the investment industry. The ICSWG-US aims to support sustainable investment practices across institutional asset owners and asset managers. Through this effort, ICSWG-US members seeks to provide perspectives from the consultant community and be a resource on activities such as standardization of environmental, social and governance ("ESG") integration and climate-related reporting, regulations, and innovations.