May 16, 2022

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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: Z-RIN 1210-ZA30, RFI on Climate-Related Financial Risk

Dear Sir or Madam:

On behalf of the SPARK Institute, Inc., we are writing in response to the Department of Labor's ("the Department's") request for information on possible agency actions to protect life savings and pensions from threats of climate-related financial risk ("the RFI").[1]

The SPARK Institute represents the interests of a broad-based cross section of retirement plan service providers and investment managers, including banks, mutual fund companies, insurance companies, third party administrators, trade clearing firms, and benefits consultants. Collectively, our members serve approximately 100 million employer-sponsored plan participants.

As the SPARK Institute has expressed in previous letters to the Department, we believe that climate change and other environmental, social, and governance ("ESG") factors are material to the risk-return profile of certain investments, and may be appropriately considered in fulfilling a fiduciary's obligations under the Employee Retirement Income Security Act of 1974 ("ERISA"). Accordingly, the SPARK Institute would like to take this opportunity to reiterate our support for the Department's October 2021 proposed changes to its Investment Duties Regulation that would expressly clarify that ERISA fiduciaries may appropriately consider the economic effects of climate change and other ESG factors.[2]

However, notwithstanding this previous support, the SPARK Institute has significant concerns with some of the actions that are identified in the RFI as possible steps that the Department could take to mitigate climate-related financial risks for retirement savings.

[1] 87 Fed. Reg. 8289 (Feb. 14, 2022).

[2] *See* The SPARK Institute's Letter Supporting the Department's Proposed Changes to its Investment Duties Regulation (filed December 13, 2021).

Additionally, we have concerns with some of the RFI items that raise questions about fiduciary issues for which we cannot identify reasonable differences of opinion.

I. ADDITIONAL CLIMATE-RELATED DATA COLLECTIONS

Form 5500 Reporting. The RFI includes a series of questions asking whether the Department should take action to collect additional information from retirement plans about the steps that plan fiduciaries are taking to mitigate climate-related financial risks. For example, Question #4 of the RFI asks whether the Form 5500 should be used to collect data on:

- 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;
- whether and how plans have factored climate-related financial risk into their analysis of individual investments or investment courses of action; and
- whether and how plan fiduciaries voted on proxy proposals involving climate-related financial risk.

The SPARK Institute does not believe that the Department should use the Form 5500 to collect additional information on the ways in which plan fiduciaries are taking steps to mitigate climate-related financial risks because such reporting would be far too subjective, encourage plan fiduciaries to inappropriately place the importance of climate-related financial risks over other relevant risks, and increase litigation risks for plan sponsors and other fiduciaries.

Although the Form 5500 is an appropriate tool for collecting *objective* plan information – e.g., the number of participants, the value of plan assets, or whether the plan is in compliance with a requirement of the law – it is not well suited for collecting the type of subjective information that would necessarily be involved in reporting on climate-related financial risks. For instance, there are no clear definitions for the term "climate-related financial risk," and the term may have an infinitely wide range of meanings depending on the context.[3] Additionally, as noted above, the SPARK Institute believes that climate change and other ESG issues are material to the risk-return profile of certain investments. Accordingly, depending on the context, it may be virtually impossible to analytically distinguish climate-related financial risks considered by plan fiduciaries from other financial considerations. Because there is no clear definition of the term "climate-related financial risks" and any reporting on such risks would necessarily involve subjective decision making, we urge the Department not to add this kind of reporting to the Form 5500.

In addition to the practical and analytical challenges that would be created by Form 5500 reporting on the consideration of climate-related financial risks, the SPARK Institute is also concerned that such reporting could inappropriately encourage plan fiduciaries to place climate-

[3] The uncertainty surrounding the term "climate-related financial risks" is expressly recognized in the Department's RFI, as it states that "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 (emphasis added)."

related financial risks in their investment evaluations over other types of risk. This would be a significant concern even if the Department were to clearly interpret ERISA as not requiring plan fiduciaries to consider climate-related financial risks. The mere fact that a question (or questions) regarding climate-related financial risks would be added to the Form 5500 would identify and highlight those risks apart from all other types of risk, and could cause fiduciaries to reevaluate their consideration of climate-related financial risks in an effort to select investments or report in a way that is consistent with how they perceive the Department to view the importance of climate-related financial risks.

The SPARK Institute is also very concerned about how additional Form 5500 reporting on climate-related financial risks could contribute to litigation risks that have markedly increased in recent years. Even among investment professionals, there are a wide range of views on how fiduciaries should account for climate-related financial risks and the weight that such risks should be given in any investment decision. Accordingly, we are concerned that a plan's decision to identify its consideration of climate-related financial risks on the Form 5500 would increase litigation risks just as much as its decision not to identify its consideration of climate-related financial risks on the Form 5500. In other words, from a litigation perspective, additional reporting on climate-related financial risks would present plan sponsors with a "lose-lose" proposition.

Alternative Reporting Outside Form 5500. The RFI also asks whether ERISA-covered plans should be required to report on climate-related financial risks in a way that is more easily accessible to the public, and timelier, than the Form 5500. In response to this question, the SPARK Institute strongly encourages the Department not to add any plan reporting obligations that would be required beyond the Form 5550 or more frequently than the Form 5500. Reporting plan information is a substantial effort that frequently requires coordination among various entities, including plan sponsors, plan administrators, investment managers, recordkeepers, and attorneys. Additional plan-level reporting on climate-related financial risks beyond the Form 5500, or in more frequent intervals, is unsupported by ERISA, would increase costs and administrative burdens, and would not create any appreciable benefits for plan participants or the Department.

II. ADDITIONAL CLIMATE-RELATED FINANCIAL EDUCATION

The RFI includes a series of questions about whether there is a need to educate retirement savers about climate-related financial risks and the role that the Department should play in providing such education. In response, the SPARK Institute believes that retirement savers would most benefit from comprehensive and balanced financial education on a wide range of financial topics. While the consideration of climate-related financial risks might appropriately be included as one component of that education, it would only be one component among many important factors. Each retirement saver's individual circumstances, goals, and risk tolerances are different, and there is no one-size-fits all approach for weighting the factors that will be most important to an individual investor.

In any event, we would point out that among all the areas that we need to make sure participants understand, the risks of climate change on their retirement investments is nowhere

near as critical as basic financial education. In our experience, the first task of a participant education program is to make sure participants understand the need to save a sufficient amount for a secure retirement, the value of compounding, the importance of receiving the employer matching contribution, and the need for diversification.

All of this is already reflected in the Department's existing guidance on education in Interpretive Bulletin 96-1, which supports the provision of information and materials to inform a participant or beneficiary about: "(i) General financial and investment concepts, such as risk and return, diversification, dollar cost averaging, compounded return, and tax deferred investment; (ii) historic differences in rates of return between different asset classes (e.g., equities, bonds, or cash) based on standard market indices; (iii) effects of inflation; (iv) estimating future retirement income needs; (v) determining investment time horizons; and (vi) assessing risk tolerance." These broad categories provide sufficient latitude for education on a variety of market risks.

III. THE DEPARTMENT SHOULD PRESERVE PRODUCT NEUTRALITY

The RFI includes a set of questions asking about the ways in which different types of investment products account for climate-related financial risks. For example, the RFI asks whether annuities help individuals efficiently mitigate the effects of at least some climate-related financial risk by shifting risk to insurers. Similarly, the RFI asks whether there is evidence indicating that the Thrift Savings Plan ("TSP") offers index funds that 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.

The SPARK Institute strongly supports legislative and regulatory efforts that would facilitate the inclusion of annuities and other lifetime income guarantees during the accumulation phase of retirement savings and through retirement. In fact, this is one of the central pillars of The SPARK Institute's Legislative and Regulatory Agenda. The SPARK Institute's support for these products is based on the fact that annuities are backed by insurance companies and, therefore, can help retirement savers mitigate *all types of risks*, not just climate-related financial risks. The SPARK Institute would have concerns, however, with any regulatory action that would attempt to use climate-related financial risks as a justification for the Department to promote one type of investment product over others for retirements savers. Plan fiduciaries, the marketplace, and participants – and not the government – are best positioned to evaluate the relative strengths and weaknesses of different investment products in terms of climate-related financial risks.

The SPARK Institute is also concerned with how the RFI suggests that certain indices may "systematically underestimate or overestimate the risks associated with climate change" or "fail to appropriately factor in the risks associated with climate change in pricing publicly-traded assets." More specifically, this language is concerning because it suggests that the Department misunderstands index investing in two fundamental ways:

- First, it suggests that the Department believes that indices can overestimate or underestimate a market risk such as climate change. This view is inconsistent with how index investing works. Unlike actively managed investments, passively managed index funds do not weigh or adjust their underlying assets based on an estimation of market

risks. Instead, they simply track the market as a whole. While it is possible that indices will have varying levels of exposure to climate-related financial risks based on the investments that each index reflects, the price of each asset that is part of the index will reflect the market's determination of that relative risk. It would be concerning if a government agency were to substitute its own views on those risks for the views of the market as a whole

- Second, these questions are concerning because they suggest that the Department believes that climate-related financial risks may create a distortion in the price of an index fund that simply reflects the prices of its underlying publicly-traded assets. That type of distortion, however, would be wholly inconsistent with how index funds are priced. Because the price of any publicly-traded asset that is included in an index reflects the actual price that a willing buyer and seller have agreed upon for such asset in the marketplace, we do not understand how there could be any pricing concerns regarding a fund that is tied to the index – whether those concerns relate to climate-related financial risk or any other factor.

In short, the Department raising these questions suggests it thinks plan fiduciaries *must* employ an active management strategy to plan investments because it believes that the securities market is fundamentally mispricing securities with respect to climate risk. The SPARK Institute believes that both active and passive investment management should be available to plan fiduciaries and participants, and even within index funds, plan fiduciaries are capable of making appropriate judgements about which index funds should be offered to participants.

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The SPARK Institute appreciates the opportunity to provide these comments to the Department. If the Department has any questions or would like more information regarding our comments, please contact me or the SPARK Institute's outside counsel, Michael Hadley, Davis & Harman LLP (mlhadley@davis-harman.com).

Sincerely,

Tim Rouse
Executive Director