CONSULTATION RESPONSE

US DEPARTMENT OF LABOR: PUBLIC COMMENT ON PROTECTING WORKERS' LIFE SAVINGS AND PENSIONS FROM CLIMATE-RELATED FINANCIAL RISKS. Z-RIN 1210-ZA30

16 May 2022

INTRODUCTION

The Principles for Responsible Investment (PRI) works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a range of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

The PRI develops policy analysis and recommendations based on signatory views and evidence-based policy research. The PRI welcomes the opportunity to respond to the Department of Labor's (DOL or the Department) request for public comment on protecting workers' life savings and pensions from climate-related financial risks.[1]

ABOUT THIS CONSULTATION

This consultation responds to the Department's request for public comment on protecting worker's life savings and pensions from climate-related financial risks. The request for public comment is in accordance with President Biden's May 2021 Executive Order on Climate-Related Financial Risk, which directed the Department to identify actions it can take under the Employee Retirement Income Security Act of 1974 (ERISA), the Federal Employees' Retirement System Act of 1986 (FERSA), and other relevant laws, to safeguard the life savings and pensions of US workers and families from the threats of climate-related financial risk.[2]

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1 US Department of Labor (February 2022), Public Comment on Protecting Workers' Life Savings, Pension from Climate-Related Financial Risk
2 The White House (May 2021), Executive Order on Climate-Related Financial Risks

KEY RECOMMENDATIONS

The PRI welcomes the Department of Labor and the Employee Benefits Securities Administration's (EBSA) efforts to better understand and work to mitigate the climate-related financial risks faced by American retirement savers and workers. Together, ERISA and FERSA provide oversight to more than $13 trillion in assets that over 160 million Americans rely on for their basic needs in the years after retirement.

Evidence of the causal link between efficiency of the global financial system and the sustainability of the economy, the planet and wider society continues to grow. Organizations that invest in activities that may not be viable in the longer term or subject to transition risks may be less resilient to the transition to a lower-carbon economy, and their investors will likely experience lower returns. As highlighted by the Task Force on Climate-related Financial Disclosures (TCFD), inadequate information about climate-related financial risks can create issues in asset valuation and allocation processes.[3] Research conducted by the PRI on private retirement systems shows that plan participants in the US face risks both of a financial nature and in relation to quality of life in retirement.[4] As such, plan sponsors and administrators should be working to mitigate climate-related risks in investment portfolios while designing investment strategies to participate in this economic realignment in the interest of their beneficiaries and in line with their fiduciary duties.[5]

EBSA's standing mission is to ensure the security of the retirement, health, and other workplace-related benefits of America's workers and their families.[6] The intensifying impacts of climate change present physical and transition risks to the US economy, financial capital and the sustained retirement benefits of America's workers and families. As such, EBSA is duty-bound to take active steps to address potential impacts of climate-related financial risk to American savers. The PRI encourages the Department and EBSA to take all possible actions to better understand and limit the potential risks posed by climate change to these savings. The PRI is available to assist in this effort.

The PRI recommends that the Department:

- **Consider utilizing the TCFD recommendations as a guide in efforts to help plan sponsors to develop their governance, strategy and risk management around climate-related risks, as well as to present consistent, comparable and understandable climate-related information to plan beneficiaries about what is being done to insulate their retirement savings from climate-related risks. EBSA should further consider what information is most useful to be publicly reported via summary annual disclosures or other regular reports.**
- **Work to determine the level of awareness and actions being taken by plan sponsors and administrators to consider and account for climate-related financial risks, either via survey or other engagement with covered plans.**

3 Task Force on Climate-related Financial Disclosures (June 2017), Final Report: Recommendations of the Task Force on Climate-Related Financial Disclosures
4 Wharton Pension Research Council Working Paper (July 2021), Private Retirement Systems and Sustainability: Insights from Australia, the UK, and the US (p.1)
5 The Principles for Responsible Investment (November 2020), Fiduciary Duty in the 21st Century
6The Employee Benefits Securities Administration (May 2022), Our Mission

- **Engage with third-party service providers to better understand their interactions with covered plans, including any product-specific or data-specific work tailored for pension plans to better consider climate-related risks.**
- **Consider sponsoring research to better understand the full scope of climate-related risks across the US pension market and to take better account of systemic issues within the pension markets, as well as the idiosyncratic and aggregate risks to pension plans.**
- **Consider ways to educate participants widely on how to consider the incorporation of ESG factors in their investment decision-making.**

DETAILED RESPONSE

Q1. 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?

The PRI recommends EBSA consider utilizing the TCFD recommendations as a guide in efforts to help plan sponsors to develop their governance, strategy and risk management around climate-related risks, as well as to present consistent, comparable and understandable climate-related information to plan beneficiaries about what is being done to insulate their retirement savings from climate-related risks. The PRI worked closely with the UK Department for Work and Pensions (UK DWP) to develop their guidance for trustees of occupational schemes on climate change risk.[7] This work relies heavily on the recommendations of the TCFD, which the PRI has endorsed. Alignment with the TCFD further allows for efficiencies across pension markets, with best practices considered from UK pensions and others utilizing the TCFD. Similarly, corporate reports are increasingly utilizing the TCFD as a baseline for disclosure, such as the exposure draft of the International Financial Reporting Standards (IFRS) Foundation's International Sustainability Standards Board (ISSB). Multiple entities across the investment chain utilizing the same framework can allow for efficiencies as information moves up the chain, with investors better incorporating TCFD-based disclosure of investee companies in their own TCFD-based reports, for example.

The PRI's work with the UK DWP took into account the diverse nature of private pension plans, which greatly range in size of assets under management and number of plan participants. The PRI similarly recommends EBSA consider the diversity of covered plans when developing any guidance or regulations for plan sponsors and administrators to develop climate-related processes. However, the PRI believes that TCFD-aligned climate-related reporting provides both the detail and flexibility to provide a template for EBSA to begin assisting covered plans in better understanding their climate-related risks and opportunities.

Q2. 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?

The TCFD recommendations define the term "climate-related risk" as the potential negative impacts of climate change on an organization and divide its scope into two broad categories of risks.[8] First are "transition risks," which may pose varying levels of financial risk to organizations through abrupt changes in regulation, market preferences and demand, and shifts in technology which can lead to stranded assets and lost investments. Second are "physical risks", which emanate from climate change and can be event-driven such as increased severity of extreme weather events, including droughts, floods, and fires. These physical risks may have financial implications for pension plans, including direct

7 UK Department for Work and Pensions (June 2021), Governance and reporting of climate change risk: guidance for trustees of occupational schemes

8 Task Force on Climate-related Financial Disclosures (June 2017), Final Report: Recommendations of the Task Force on Climate-Related Financial Disclosures (p.62)

damage to assets of investee companies and indirect destabilizing impacts from supply chain disruption, operations, and property.

Additionally, a paper published by the International Organisation of Pension Supervisors, highlights a third category of risks related to climate change, "liability risks". As indicated in the paper, this type of risk "may affect insurers, governments, and government agencies due to legal or moral responsibility to cover financial losses caused by climate-change-induced events."[9]

As stated in the TCFD recommendations, evidence suggests that inadequate information about risks, including climate-related risks, can create issues in asset valuation and allocation processes,[10] and thus, potentially give rise to concerns about the protection of life savings and pension plans of US workers and families. As such, the PRI believes that it is essential that climate-related financial risks are taken into account by plan sponsors and administrators.

Q3. 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.

Yes, EBSA should consider referencing the work of the UK DWP, which the PRI assisted in developing.[11] The UK DWP closely mimics the recommendations of the TCFD, calling for pension plans to develop information around governance, risk management, strategy and metrics, and targets, among other items. The PRI believes the TCFD can serve as a model for EBSA to begin gathering information from plans, and for plan sponsors to better understand and be able to manage their climate-related risks. Utilizing the TCFD to begin accounting for climate-related risks is consistent with EBSA's mandate as climate change has implications for the mid- and long-term health of portfolios and Americans' pensions.

Aligning any information guidance for plan sponsors and administrators with information provided by the Securities and Exchange Commission (SEC) disclosures can limit the burden on plan sponsors and administrators and create efficiencies for beneficiaries in understanding what disclosed information means for their retirement savings.

The PRI notes that staff resources, data availability, methodological limitations and associated costs may present pension plans with challenges in compiling and disclosing the recommended information above. EBSA should consider initiatives to limit the implementation burdens on plans by providing flexibility, resources and guidance and consider amending requirements based on the size of plans, such as levels of reporting specificity. The UK DWP considered plan limitations by including an "As far as they are able" caveat to a number of recommended quantitative disclosures, for example.

9 International Organisation of Pension Supervisors (2019), Supervisory Guidelines on the Integration of ESG Factors in the Investment and Risk Management of Pension Funds (p.17)
10 TCFD, p.1
11 UK Department for Work and Pensions (June 2021), Governance and reporting of climate change risk: guidance for trustees of occupational schemes

Q5. 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 an other way?

EBSA should work to determine the level of awareness and actions being taken to consider and account for climate-related financial risks. This can be done via survey. Establishing a baseline of covered plans will prove critical for EBSA to determine the types of information and guidance needed by plan sponsors, administrators and plan participants. Information gathering efforts should individually target all three of these audiences separately, as there may be a disconnect between what sponsors or participants believe plan administrators are doing to address climate-related risks, for example.

Q6. 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?

EBSA should consider how plan administrators can best utilize the TCFD recommendations to identify, assess and manage climate-related risks, including whether and how this information should be publicly reported. Publicly reported information would provide plan participants with relevant information on how administrators address risks that are the most significant to successfully executing their plan objectives and strategy. Such information could be provided in a summary annual report or in a separate regular disclosure. In considering what information to require and what is necessary to report publicly, EBSA should take into account resource limitations of the diverse set of covered plans.

ERISA FIDUCIARY DUTIES

Q7. 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?

EBSA should engage with third-party service providers to better understand their interactions with covered plans, including any product-specific or data-specific work tailored for pension plans to better consider climate-related risks.

Pension plans often rely on a wide network of third-party service providers in order to facilitate the day-to-day management and investment activities necessary. The PRI's report on the US retirement system highlighted the important role that service providers such as asset managers, recordkeepers and investment consultants play and the challenges this can cause for introducing sustainability initiatives within the system.[12] Similar findings were relevant for the PRI's review of the UK and Australia.[13] EBSA should seek to understand how this network of third-parties engages with covered plans on climate-related issues. Understanding the full scope of relationships can shine light on challenges and assist EBSA in mitigating some of the barriers to covered plan fiduciaries evaluating and taking action on climate-related risks.

Beyond service providers, there are numerous other government agencies and actors that operate alongside EBSA within the US retirement system. EBSA can similarly research the influence of these broader actors on the US retirement system and should seek to take a holistic approach to any actions taken as a result of this consultation, engaging with the wider retirement system to provide coordinated guidance and resources to market participants.

Q19. 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?

The PRI's landmark report *A Legal Framework for Impact* (LFI), commissioned in conjunction with the United Nations Environment Programme (UNEP) Finance Initiative and Generation Foundation, and authored by the law firm Freshfields Bruckhaus Deringer, analyses the extent to which legal frameworks enable investors to consider impact in their investment processes.[14] The LFI report includes analysis of

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12 Principles for Responsible Investment (2020), Private retirement systems and sustainability: United States (p.18) and Principles for Responsible Investment (2020), Private retirement systems in Australia, the United Kingdom, and the United States (p.6)
13 Principles for Responsible Investment (2020), Private retirement systems in Australia, the United Kingdom, and the United States
14 Principles for Responsible Investment (2021) A Legal Framework for Impact

the rules guiding retirement plans to conclude if and how sustainability and impact can be considered. Among others, the LFI report reviewed the “sole interest” rule that bounds retirement plans in the US, to which LFI concludes: “In our view, acting in the ‘sole interest’ would require a trustee to consider instrumental [investing for sustainability impact] strategies to address the material sustainability risks and opportunities that may affect the financial interests of its beneficiaries.[15] Freshfields further concludes that the Uniform Prudent Investor Act (1992) (“UPIA”) would “require a trustee to consider whether there are any factors that create material risks or opportunities in seeking to achieve the financial investment objective of the trust, including those that could arise as a result of sustainability factors.[16]

The PRI's response to the Department's proposed rules “Prudence and Loyalty in Selecting Plan Investments”[17] highlighted how the current rules established by the Department place ERISA-covered funds at a disadvantage relative to other investors. The Department's rulemakings finalized in 2020, “Financial Factors in Selecting Plan Investments” and “Fiduciary Duties Regarding Proxy Voting and Shareholder Rights” include numerous confusing, contradictory and burdensome provisions that have created uncertainty and unnecessary complexity for investors looking to consider ESG factors in their investment process. In fact, the nature of these rules encourages fiduciaries to go against their duties by ignoring or giving less deference to ESG and climate-related factors than their potential economic relevance would otherwise dictate a reasonable investor to consider.[18]

The PRI believes that the most expeditious way to clarify for ERISA-covered funds their ability and duties related to climate-related risks is to finalize the proposed rule "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights" as proposed.

Furthermore, numerous plan administrators and investment managers not bound by ERISA continue to follow many of its requirements as best practice,[19] and clarification by the Department for ERISA-covered funds would similarly support these entities in appropriately considering climate-related information. Growing evidence shows that climate change presents new challenges to global economies, domestic markets and businesses worldwide and PRI research has shown that IRAs, together with 401(k) plans, are the fastest-growing segments in the US pension market in terms of assets under management.[20] Thus, it is crucial to remove legal and regulatory barriers to adequate management of climate-related financial risks associated with these investment vehicles for life savings and pensions of US workers and families.

15 Principles for Responsible Investment (2021) A Legal Framework for Impact: Sustainability impact in investor decision-making: (p.516)
16 Principles for Responsible Investment (2021) A Legal Framework for Impact: Sustainability impact in investor decision-making: (p.517)
17 Principles for Responsible Investment (December 2021) Consultation Response: U.S. Department of Labor: Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights
18 Principles for Responsible Investment (December 2021) Consultation Response: U.S. Department of Labor: Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights (p.3)
19 See TIAA (2021), Best practices for confident plan compliance and Boutwell Fay LLP (July 2018), Should I Care About Fiduciary Responsibility if my Organization's Benefit Plan is Exepmt from ERISA?
20 Principles for Responsible Investment (2020), Private retirement systems and sustainability: United States

Q20. 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?

EBSA should consider sponsoring research to better understand the full scope of climate-related risks across the US pension market, reviewing both systemic issues within the pension markets, as well as the idiosyncratic and aggregate risks to pension plans.

With respect to systemic risks, EBSA should seek to understand how the various scenarios of transitioning to a low-carbon economy, and the related impacts from climate change, could change the US pension landscape overall. This could be in the form of historic shifts of capital away from certain markets toward sustainable or transition-related markets or a general shift in demand and use of retirement products and services.

Regarding idiosyncratic issues, EBSA should seek to understand average portfolio exposure to certain industries most likely to be impacted by climate change, such as extractive industries. EBSA could similarly conduct research to understand the potential impact on plans from climate shocks or abrupt transitions to low carbon economies. Analyzing this data at various aggregated levels can present insights on relative exposure based on location, size, type of plan, etc.

Question 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, there is a need to educate participants widely on how to consider the incorporation of ESG factors in their investment decision-making. Research from the Organisation for Economic Co-operation and Development (OECD) shows asymmetries between the information available to and understood by pension plans and participants due to the complexity of products, and difficulties in the valuation of assets and liabilities, among other things.[21] Similarly, a recent survey conducted by the International Organization of Securities Commissions (IOSCO) concluded that financial investor education is an instrumental tool that can help support sustainable finance and protect investors against greenwashing and sustainability-related risks.[22] Financially literate participants in the US would be better equipped to face the growing complexity of investment products, which could serve to improve their investment outcomes in the long run.

The PRI therefore recommends that EBSA play a significant role in sponsoring and providing education initiatives relating to sustainable finance, including climate-related financial risks. This role should be in coordination with, and complementary to, the SEC's investor education programs.[23] EBSA should also look to the work being done in other jurisdictions around the world for best practices and resources. More than half of the jurisdictions included in the IOSCO survey have implemented at least one

21 Organisation for Economic Co-Operation and Development, Financial Education and Saving for Retirement (p.5)
22 International Organization of Securities Commissions (November 2021), Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management (p.54-p.55)
23 U.S. Securities and Exchange Commission (May 2022), Investor Education

financial education program in relation to sustainability-related risks, and several other jurisdictions intend to undertake such initiatives in the future.

Q22: 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?

Yes, there is a need to educate owners of IRAs about climate-related financial risks and ESG factors more broadly in their investment decision-making. Research conducted by the PRI found that individual savers are faced with complex investment choices that they are generally ill-equipped to make due to the complexity of products and a lack of knowledge about financial markets. As a result, investors rely on advisers to make investment decisions, which has led to some concerns about the levels of consumer protection from advisers given current regulatory regimes.[24] Overall, there are low levels of customer engagement and switching, and limited commercial incentives for providers to introduce new sustainable products or services.

The PRI believes that EBSA should work together with other relevant regulatory agencies to ensure American investors and savers are fully informed about climate-related risks and the use of ESG information in investment decision-making.

The PRI has experience of public policy on sustainable finance policies and responsible investment across multiple markets and stands ready to further support the work of the Department of Labor to identify and work to mitigate risks to workers' savings and pensions stemming from climate-related financial risks in the United States.

Any question or comments can be sent to policy@unpri.org.

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24 Principles for Responsible Investment (2020), Private retirement systems in Australia, the United Kingdom, and the United States