July 21, 2020

Office of Regulations and Interpretations
US Department of Labor
Room N-5655
200 Constitution Avenue NW Washington, DC 20210
Online submission - https://www.regulations.gov/comment?D=EBSA-2020-0004-0002

RE: Proposed rule on Financial Factors in Selecting Plan Investments (RIN 1210-AB95)

Dear Secretary Scalia:

The Sustainability Accounting Standards Board (SASB) respectfully submits the following comments on the Department of Labor’s proposed rule, “Financial Factors in Selecting Plan Investments” (RIN 1210-AB95) (the “Proposal”).

1. By way of background, SASB is an independent non-profit organisation established in 2011 to set standards for companies to use when disclosing sustainability information to investors. SASB standards are categorised into 77 industry-specific disclosure standards, incorporating 26 issues that relate to five dimensions of sustainability: environment, social capital, human capital, business model and innovation, and leadership and governance. By providing transparency into how companies are managing financially material sustainability risks and opportunities, SASB standards enable capital markets participants to more effectively allocate resources toward organisations and activities that create mutually beneficial value for companies, investors, and society more broadly.

SASB standards are created through evidence-based research, broad and balanced market input, public transparency, and independent oversight. The standards are designed to be driven by input from capital market participants such as companies, investors, and other subject matter experts. This work is carried about by an independent standard-setting board and overseen by the SASB Foundation Board of Directors in a governance structure similar to that adopted by other internationally recognised bodies that set standards for disclosure to investors, including the Financial Accounting Standards Board and the International Accounting Standards Board.

SASB standards are used by investors and companies globally. More than 145 asset owners and asset managers, representing approximately $53.2 Trillion in assets under management, across 18 countries participate in SASB’s Investor Advisory Group and/or in the SASB Alliance and/or have licensed the standards for use in investment processes. Companies reporting SASB metrics span 60 industries in 34 countries.

2. For purposes of the DOL Release, the most significant aspect of SASB’s work is that it identifies ESG factors that are reasonably likely to be financially material. SASB staff have devoted years of research in this effort, and they continue to do so as new topics or developments are identified. “Materiality” in this context means what is likely to be important to an investor making his or her investment or voting decisions and what is reasonably likely to impact financial performance of the typical company in an industry.
Numerous analyses and peer reviewed publications have found that ESG factors can indeed be material to a company’s operating performance, financial condition, credit risk profile, and/or stock performance. These studies demonstrate that financially material ESG factors are relevant for investment decision making. Here are several examples of studies that have focused specifically on the SASB standards:

**Global Alliance for Banking on Values (GABV),** Do sustainable banks outperform? Driving value creation through ESG practices (May 2020). Using the SASB standard for Commercial Banks and SASB definition of materiality, this research evaluated public data on 100 banks. “In analyzing their stock returns from 2007 to 2017, we determined that those banks that consistently scored high on material ESG issues delivered higher risk-adjusted returns compared to those banks that performed poorly on the same issues, while the opposite was found for immaterial ESG issues. These results suggest that a focus on material sustainability issues is likely to coincide with enhanced financial returns.”

Witold J. Henisz and James McGlinch, Wharton School, University of Pennsylvania, ESG, Material Credit Events, and Credit Risk (Journal of Applied Corporate Finance, July 2, 2019). A study, “ESG, Material Credit Events, and Credit Risk,” by Professor Witold J. Henisz and Doctoral Student James McGlinch of the University of Pennsylvania’s Wharton School published in the Journal of Applied Corporate Finance illustrates the connection between ESG performance and credit risk. “Our study is the first large-sample empirical study of the mechanisms that link ESG performance to credit risk, said Henisz, “We found that Truvalue Labs’ ESG scores capture timely and material events such as regulatory inquiries, investigations and lawsuits, which are correlated with credit risk and the likelihood of default.”

BlackRock, Sustainable investing: a ‘why not’ moment: environmental, social and governance investing insights. (May 2018). BlackRock researchers applied SASB’s Sustainable Industry Classification System® (SICS®) to the Russell 1000 Index and compared the results to the General Industry Classification System (GICS) across eight years of data. They found that (a) pairwise correlations between sectoral returns were lower than GICS and (b) pairwise correlations of excess returns of individual stocks within sectors were comparable to that of GICS.

Russell Investments, Materiality matters: Targeting the ESG issues that can impact performance (Feb. 2018). Russell Investments mapped SASB’s Materiality Map® general issue categories to Sustainalytics subcategories to adapt the Sustainalytics company ESG scores by calculating a new Material ESG score based on what SASB identifies for a company based on its SICS® industry. Using the Material ESG score to analyze companies from 2011 to 2017, they found evidence that the Material ESG scores are better predictors of return compared to the original score, even after adjusting for known drivers of equity returns (such as factor exposures).

Mozaffar Khan, George Serafeim and Aarn Yoon, Corporate Sustainability: First Evidence on Materiality (Harvard Business School, March 9, 2015). The authors mapped SASB’s Materiality Map® general issue categories to MSCI KLD data for 2,307 unique firms over 13,397 unique firm-years across six SICS® sectors. Using both calendar-time portfolio stock return regressions and firm-level panel regressions they found that firms with good ratings on SASB’s material sustainability issues significantly outperformed firms with poor ratings on these issues. In contrast, firms with good ratings on immaterial sustainability issues (ESG issues not identified by SASB for a given industry) did not significantly outperform firms with poor ratings on the same issues. Lastly, they found that, all else equal, firms scoring in the top quintile on the material issues have higher future return-on-sales growth.

3. Because of these findings, the DOL Release strikes us as off-the-mark. The Release does acknowledge the potential materiality of some ESG factors, citing as examples “a company’s improper disposal of hazardous waste” or “dysfunctional corporate governance.” At the same time,
however, the Release expresses substantial concern that some ERISA fiduciaries are making investment decisions “on the basis of purported benefits and goals unrelated to financial performance.” Thus, the Release asserts, “ESG investing raises heightened concerns under ERISA.” Further, the proposal would require that a plan sponsor prepare special documentation for any decision to choose an ESG-oriented alternative from among economically equivalent options.

Why, given the evidence of financial materiality found by SASB and numerous scholars, would ESG investing be singled out by DOL for a special rule, a special documentation requirement, and a “heightened” level of scrutiny? The DOL’s pejorative treatment of ESG investing seems designed to tamp down on such activity despite the materiality assessments reached by SASB and other experts in this area. That is, indeed, the way that the Proposal is being broadly interpreted. See, e.g., Groom Law Group (Legal Memorandum), “DOL Proposes Rules to Crack Down on ESG”, June 25, 2020; Pensions and Investments, “DOL Proposal Could Chill Prospects for ESG Investing in ERISA Plans”, June 26, 2020; Seyfarth (Legal Memorandum), “Has the DOL Closed the Door on ESG Investing in ERISA Plans?”, July 10, 2020; Martin Lipton, Wachtell, Lipton, Rosen & Katz, Harvard Law School Forum on Corporate Governance, July 7, 2020 (stating that “it is particularly anomalous, especially in these times, for the DOL to limit or unduly burden the ability of plan fiduciaries to exercise a judgment that items like good corporate governance, effectively navigating energy transitions or operating in a sustainable manner can enhance or protect returns.”).

The end result of the DOL’s Proposal would be harmful, rather than beneficial, to plan beneficiaries. And because the Release fails to offer an evidentiary basis for its approach, the efficacy of the Proposal under an arbitrary and capricious standard of administrative rulemaking would be seriously in doubt.

4. There are two additional troublesome aspects of the Release that we believe should be emphasized:

First, the rule and its supporting release would lead to considerable confusion (and corresponding costs). SASB is particularly concerned about the DOL’s imprecision with respect to “pecuniary versus non-pecuniary” factors. The impact of some ESG factors might not be apparent over a short-term period, such as a quarter or a year, and may be more long-term in nature. A plan fiduciary should be permitted to take long-termism into account, but the Release casts doubt on whether, and when, that might be allowed. It may be that the DOL intends such imprecision to discourage the consideration of ESG factors in investment decision-making, but, again, this is not a reasonable use of the agency’s rulemaking authority.

Second, the proposal would prohibit a 401(k) plan from providing a qualified default investment alternative with an ESG component, no matter how small, even if that investment alternative satisfies the pecuniary factor requirements. Such a prohibition further demonstrates the DOL’s bias against integrating ESG factors into investment decisions and/or investment products, a bias that lacks evidentiary support.

We appreciate your consideration of our comments, and we urge that the Proposal be withdrawn.

Respectfully submitted,

Janine Guillot, CEO
Sustainability Accounting Standards Board