

INCLUSIVE CAPITAL PARTNERS

Inclusive Capital Partners, LP
1170 Gorges Avenue
San Francisco, CA 94129

July 30, 2020

Office of Regulations and Interpretations
U.S. Department of Labor
Room N-5655
200 Constitution Avenue NW
Washington, DC 20210

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

To whom it may concern:

We write to provide comments in response to the Department of Labor's proposed rule, "Financial Factors in Selecting Plan Investments" (RIN 1210-AB95) (the "Proposal").

Inclusive Capital Partners invests in businesses where we have the opportunity to engage on material environmental and social issues to generate outsized shareholder value by unlocking the benefits to such excluded, yet intrinsic, stakeholder groups as the planet, its societies and their future generations.

Over decades of investing and corporate work, the principals of Inclusive Capital Partners have seen how business practices can generate long-term shareholder value while also imparting broadly shared economic prosperity and diverse stakeholder value in a capitalist economy based on public policy and market rules that reinforce the inclusive, innovative and productive powers of our economic system.

In the current circumstances of the Covid-19 pandemic, social unrest caused by racial injustice and dangerous levels of unemployment, corporate America is seeking to grow and act in new ways to heal pains in our country.¹

¹ JUST Capital (2020), "COVID-19 Corporate Response Tracker": <https://com-justcapital-web-v2.s3.amazonaws.com/interactives/covid19-response-tracker-v4/index.html>; and JUST Capital (June 30, 2020), "These Are the Corporate Responses to the George Floyd Protests That Stand Out": <https://justcapital.com/news/notable-corporate-responses-to-the-george-floyd-protests/>

The DOL is correct to prioritize the importance of shareholder returns, but by making the incorporation of environmental, social and governance (ESG) factors more burdensome, the Department is actually putting successful returns at risk. Properly conceived and executed ESG strategies ensure risk reduction and return optimization.

In light of this, the Department's Proposal can be read in no other way than to put a chilling effect on such strategies with rules that hinder inclusiveness and sustainability as well as harm the well-being of millions of American families who have collectively entrusted \$10.1 Trillion into the Employee Benefits Security Administration, or about 12 percent of all U.S. household financial assets.² Given the influence of the ERISA rules, the Proposal would have further impact on the broader pension fund community, where Americans place an additional \$18.6 Trillion in other retirement investments, such as public pensions IRAs and other instruments.^{3,4}

The Proposal reveals a fundamental misunderstanding of how professional investment managers can effectively use ESG criteria as an additional level of risk mitigation, due diligence and analysis in their portfolio construction. Investment managers increasingly analyze ESG factors precisely because they view these factors as material to financial performance.

The Proposal lacks confidence that such ESG information can have the degree of certainty that prudent investors require. However, this could not be further from the truth. Total employee costs, gender pay equity, employee turnover, levels of diversity and skills training investment are all quantifiable and concrete data points. On the issue of climate change, the fluctuating costs of raw material, compliance, R&D for new product innovations and shifts in consumer preferences are valuable and material information for investors, with 473 financial institutions representing more than \$138 Trillion demanding climate-related financial disclosures.⁵

The evidence is growing that companies with a clear focus on the well-being of their customers, employees, communities and the planet have lower cost of capital and improved cash flow, as well as improved operational and stock performance.⁶ The GAO recently emphasized in a report that

² Employee Benefits Security Administration (2020): <https://www.dol.gov/agencies/ebsa/about-ebsa/about-us/what-we-do>

³ Investment Company Institute (June 17, 2020), "Quarterly Retirement Market Data, First Quarter 2020": https://www.ici.org/research/stats/retirement/ret_20_q1

⁴ Ceres (July 30, 2020), "Major investors oppose proposed rule that would impede ESG investing": <https://www.ceres.org/news-center/press-releases/major-investors-oppose-proposed-rule-would-impede-esg-investing>

Martin Lipton (July 7, 2020), "DOL Proposes New Rules Regulating ESG Investments": <https://corpgov.law.harvard.edu/2020/07/07/dol-proposes-new-rules-regulating-esg-investments/>

⁵ TCFD (February 12, 2020), "More than 1,000 Global Organizations Declare Support for the Task Force on Climate-related Financial Disclosures and its Recommendations": https://www.fsb-tcfd.org/wp-content/uploads/2020/02/PR-TCFD-1000-Supporters_FINAL.pdf

⁶ Gordon L. Clark et al. (October 22 2014), "From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance": <https://ssrn.com/abstract=2508281>

not only do ESG factors help indicate a company's long-term financial performance, but that investors need more ESG information to better assess long-term value.⁷

The Proposal exhibits a further lack of understanding about the needs and desires of the very pensioners that the Department of Labor is responsible for protecting. According to a survey this year by asset manager Nuveen of more than 1,000 high net worth investors and financial advisors, 54 percent said they would invest their retirement funds entirely in responsible investments focused on ESG issues.⁸ 96 percent of investors surveyed by EY reported that ESG information is "pivotal" in decision-making.

At this time, when customers, businesses and investors are stepping up to reform capitalism to reflect their proper role in supporting the common good, it is perverse for the Government to take actions turning America back toward investment practices of the past, which created a race to the bottom by rewarding business activities that create short-term stock price movements regardless of long-term harm.

As the rest of the industrialized world races to the top, U.S. policies such as the Proposal will foster market practices that will put the United States at the bottom. The UK government has already revised fiduciary regulations to specifically accommodate ESG factors in pension fund investments and proposes greater corporate climate risk disclosures.⁹ The European Union is paving the way by requiring asset managers to integrate ESG metrics into investment considerations and address climate change.¹⁰ The government of Japan has established a Stewardship Code to promote sustainable growth as a fiduciary duty and made the corporate reporting of science-based targets central to its national climate strategy.¹¹

⁷ United States Government Accountability Office (July 2020), "Public Companies: Disclosure of Environmental, Social, and Governance Factors and Options to Enhance Them": <https://www.gao.gov/assets/710/707949.pdf>

⁸ Leslie P Norton. (June 26, 2020), "Companies and Investors Heed the Call to Action", *Barron's*: <https://www.barrons.com/articles/why-big-companies-have-embraced-social-responsibility-51593215927>

⁹ Department for Work & Pensions (September 2018), "Clarifying and strengthening trustees' investment duties": https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/739331/response-clarifying-and-strengthening-trustees-investment-duties.pdf; and

Financial Conduct Authority (March 2020), "Proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations": https://www.wlrk.com/docs/FCA_Consultation_Paper.pdf

¹⁰ Anna Maleva-Otto et al. (March 24, 2020), "New ESG Disclosure Obligations", *Harvard Law School Forum on Corporate Governance*: <https://corpgov.law.harvard.edu/2020/03/24/new-esg-disclosure-obligations/>; and

European Central Bank (May 20, 2020), "ECB launches public consultation on its guide on climate-related and environmental risks": <https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200520~0795c47d73.en.html>

¹¹ The Council of Experts Concerning the Japanese Version of the Stewardship Code (February 26, 2014), "Principles for Responsible Institutional Investors": <https://www.fsa.go.jp/en/refer/councils/stewardship/20140407/01.pdf>; and

All of these nations, as well as the corporations that are acting in inclusive and sustainable ways, understand the enormous risks of a corporate sector that does not act to stem the tide of health disasters, racial injustice, income inequality, social unrest and environmental catastrophe. Capital markets are a more powerful force than governments to mitigate these risks and seize the opportunities available to those who heal the harm. However, Government must support these efforts, not hinder them.

Rather than creating additional hurdles for fund managers who seek investments that create outsized returns **because** of their positive impact on societal and environmental problems, at the very least decent policy would require the incorporation of these factors into pension fund investment decisions as a risk mitigation strategy. In doing so, the capital markets would help bend the curve of history toward a dynamic economy, as well as a just and inclusive society.

For these reasons, the Proposal is likely to have the perverse effect of dissuading fiduciaries, even against their better judgment, from offering options for their plans that consider ESG factors as part of the evaluation of material financial criteria. As a result, it will unfairly, and harmfully, limit plan diversification and perhaps compel plan participants to choose options that are either riskier or less profitable.

We respectfully request that the Proposal be withdrawn. Thank you for your consideration of these comments.

Sincerely,

Inclusive Capital Partners

The Government of Japan (June 2019), "The Long-term Strategy under the Paris Agreement: Cabinet Decision": <https://unfccc.int/sites/default/files/resource/The%20Long-term%20Strategy%20under%20the%20Paris%20Agreement.pdf>