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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: RIN 1210-AC03 – Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights

The Natural Resources Defense Council ("NRDC") encourages the Department of Labor to finalize its proposed rule, "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights." The proposal appropriately withdraws two rules from the previous administration, "Financial Factors in Selecting Plan Investments"¹ and "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights,"² that discouraged plan managers from incorporating environmental, social, and governance ("ESG") factors, including the risks and opportunities of climate change, into their risk-return analyses for selecting plan investments and exercising shareholder rights.

NRDC is an international nonprofit environmental organization with more than 3 million members and online activists. Since 1970, our lawyers, scientists, and other environmental specialists have worked to protect the world’s natural resources, public health, and environment. NRDC has offices in New York City, Washington D.C., Los Angeles, San Francisco, Chicago, Montana, and Beijing. Through its finance and legal experts, NRDC remains engaged in financial regulation and views sensible financial regulation as an integral part of mitigating climate change.

The Employee Retirement Income Security Act ("ERISA") requires that a fiduciary "discharge his duties" to the plan "solely in the interest of the participants and beneficiaries" and act "for the exclusive purpose of providing benefits to participants and their beneficiaries; and defraying reasonable expenses of administering the plan."³ Under Supreme Court precedent, "the term ‘benefits’ in [section 1104(a)] must be understood to refer to the sort of financial benefits (such as retirement income) that trustees who manage investments typically seek to secure for the trust’s beneficiaries."⁴

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Under the Department’s long-standing ERISA regulations “a fiduciary’s compliance with the prudent-man standard requires that the fiduciary give ‘appropriate consideration’ to whether an investment ‘is reasonably designed, as part of the portfolio . . . to further the purposes of the plan, taking into consideration the risk of loss and the opportunity for gain (or other return) associated with the investment.”

The proposed rule implements these ERISA requirements by clarifying that fiduciaries may consider ESG factors as part of a risk-return analysis for plan investments. The 2020 rules that the proposal withdraws depended on the false premise that a fiduciary would consider ESG factors such as climate change only because of their collateral benefits and not because of the financial benefits to the retirement plan. “ESG investing raises heightened concerns under ERISA,” according to the final rule on selecting plan investments, because “the growing emphasis on ESG investing may prompt ERISA plan fiduciaries to make investment decisions for purposes distinct from providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plan.” The Department traditionally recognized that this was a risk with every type of investment. A fiduciary could invest in a company because of its solid returns, or because the fiduciary’s cousin happens to work there. There is no investment factor that is totally incapable of being misapplied, which is why the Department adopted an across-the-board regulation to enforce ERISA’s duty of prudence and loyalty that requires fiduciaries to make investment decisions based on financial benefits to the plan beneficiaries, rather than any second-order benefit that the fiduciary may be trying to obtain. The 2020 rules never explained why ESG risk-return analysis must be singled out for unfavorable regulatory treatment in this regard. And the Department’s chosen means of managing the supposed conflict presented by ESG – a regulatory distinction between “pecuniary” and “non-pecuniary” factors in investment decisions, and a prohibition on the use of “non-pecuniary” factors – introduced a conceptual muddle where it was not needed. As the Department recognized in its proposed rule, its previous non-regulatory guidance emphasized that fiduciaries may not pursue goals other than providing financial benefits to the retirement plan, but that financially relevant climate change and other ESG risks can be a proper subject for risk-return analysis. The Department’s proposed rule returns to this sensible approach and should be adopted.

Moreover, abundant evidence confirms that the economic risks of climate change are appropriate risk-return factors for a fiduciary to consider. “Climate change,” according to the Financial Stability Oversight Council, “is an emerging threat to the

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financial stability of the United States.”¹⁸ The White House’s Climate Finance Report also emphasized that climate change poses risk for individual companies: “Across the board, hidden and underestimated risks from climate change obscure the growing potential for business disruptions, productivity loss, and bankruptcies.”¹⁹ Climate-related financial risks fall, broadly speaking, into two categories: physical risks and transition risks. “Physical risks refer to the harm to people and property arising from acute, climate-related disaster events such as hurricanes, wildfires, floods, and heatwaves as well as longer-term chronic phenomena such as higher average temperatures, changes in precipitation patterns, sea-level rise, and ocean acidification.”¹⁰ Transition risks arise “from the shifts in policy, consumer and business sentiment, or technologies associated with the changes necessary to limit climate change.”¹¹

Physical risk is widespread. Telecommunications, energy, and transportation risk the destruction and degradation of infrastructure because of extreme weather.¹² Agriculture risks declining crop yields, poorer health of farmworkers, and degraded soil and water quality.¹³ Manufacturing risks supply chain disruptions from more powerful storms. Investors with commercial real estate holdings in low-lying coastal areas risk that those properties will become unusable and uninsurable. Other types of risk are common to all industries. Climate change will lead to degraded air quality, disease, food contamination and scarcity, and physical and mental health injuries from extreme events like wildfires, floods, and hurricanes. In addition to their significant human toll, these health effects could reduce labor productivity.¹⁴ Damage to labor markets would also reduce personal incomes and expenditures, which would in turn hurt consumer industries.¹⁵ Extreme weather events create physical risks because “individual assets, industries, and communities, as well as entire regional and national economies, remain highly vulnerable to the weather.”¹⁶ Swiss Re estimated that in 2017,

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¹⁰ Íd. at 12.
¹¹ Íd. at 13.
¹² CFTC, Market Risk Advisory Committee, Managing Climate Risk in the U.S. Financial System at 14, 16-17 (2020).
¹³ Íd. at 13-14.
¹⁴ Íd. at 17-18.
¹⁵ Íd. at 19.
extreme weather events caused $326 billion in damages globally. That is the highest figure on record.

Transition risks are also widespread. That reflects uncertainty about how state and federal government – and for some companies, foreign governments – will respond to climate change. Carbon taxes and emissions limits are a source of legal and regulatory risk that most companies readily identify when surveyed. Consumer preferences may also shift in reaction to climate change. Stranded assets – from, for example, supply chain changes or shifts in consumer preference – are thus a major source of transition risk for fossil fuel producers and other heavy industries, such as steel production. Hydrocarbon reserves, may also be stranded and devalued as consumers and energy producers adopt clean energy technologies. Financial firms must also account for transition risk in their loan and investment portfolios.

Estimates of the economic impact of climate change depend on both the timeframe under examination as well as the severity of warming. One study estimated the economic effects of climate change in the United States by 2090 under two scenarios: one assuming that temperatures rise an average of 4.3 degrees Celsius from pre-industrial levels, and one assuming that temperatures rise an average of 2.4 degrees Celsius above pre-industrial levels. Under the more dramatic warming scenario, the costs attributable to climate change would be $513 billion per year; they would be $283 billion per year under the lower warming scenario. That is in the long-term. In the

17 Id.
18 Id. ("53% of companies reporting to CDP identify inherent climate-related risks with the potential to have a substantive financial or strategic impact on their business, with almost double the number of transition risks versus physical risks reported overall.").
19 MRAC Report, supra note 33, at 19.
20 See, e.g., U.S. Steel Scraps Investment Project In Mon Valley Works, CBSLocal, Apr. 30, 2021, available at https://pittsburgh.cbslocal.com/2021/04/30/us-steel-cancels-mon-valley-works-project/, (Statement of David Burritt, President and CEO of U.S. Steel Corporation, explaining that a planned steel mill investment in Pittsburgh was scuttled, in part, because "we expanded our understanding of steelmaking’s future in a rapidly decarbonizing world.").
21 Id. at 19-20.
22 MRAC Report, supra note 33, at 20.
23 Jeremy Martinich & Allison Crimmins, Climate Damages and Adaptation Potential Across Diverse Sectors of the United States, Supplementary Information, Tbl. 5, author manuscript with supplementary information available at https://www.ncbi.nlm.nih.gov/pmc/articles/PMC6483104/, published as 9 Nature Climate Change 397 (2019) (tallying economic impacts from RCP4.5 and RCP8.5 scenarios); SENSES, Climate Change Scenarios, Mitigation, https://climatescenarios.org/primer/mitigation/ (estimating that RCP4.5 is about 2.4
more immediate term, the Carbon Disclosure Project reported that 215 of the world’s 500 largest companies collectively identified approximately $1 trillion in climate risks to their businesses as of 2018. Over half of these risks were projected as likely to occur within the next five years.

Climate change also presents opportunities for companies, particularly within industries like renewable energy or eco-friendly construction that will profit from a transition to a low carbon economy. Financial firms may also profit from opportunities to issue or invest in green bonds to finance climate infrastructure investments.

It is obvious from the foregoing that a prudent fiduciary may conclude that climate change is relevant to the risk-return analysis for a retirement plan. Especially as pension obligations have a lengthy time horizon, a prudent fiduciary could decide that climate change will result in portfolio losses and take steps to manage that risk, or decide that certain investments will benefit from a transition to a low-carbon economy. The Department’s current regulation, however, inappropriately discourages fiduciaries from incorporating climate change into their investment analyses. The 2020 regulation introduced a new distinction between “pecuniary” and “non-pecuniary” factors that differs, in some undefined way, from the Department’s longstanding regulations around financially relevant factors. The regulation casts no light on how fiduciaries can incorporate this distinction into their investment process. Climate change, for example, has obvious financial impacts but stems from environmental and operational issues that may be considered “non-pecuniary.” The 2020 regulation’s “pecuniary” and “non-pecuniary” test creates needless confusion. The Department should adopt revisions to paragraph (b)(2)(ii)(C) and (b)(4) in section 2550.404a-1 to clarify that fiduciaries may consider climate change in the same way that they can consider any other relevant risk-return factor.

The Department is also correct to reformulate the “tie-breaker” standard in paragraph (c) of the 2020 regulation. Provided that the fiduciary has identified multiple prudent options, there is no need for extensive additional documentation explaining why the fiduciary used any factor – including ESG – to select among prudent alternatives. The Department should of course require fiduciaries to document the

degrees C and RCP8.5 is about 4.3 degrees C above preindustrial times by the end of the century).

25 Id.
27 Id.
process of identifying prudent investment options, but the 2020 regulation’s documentation requirements serve little additional purpose.

The Department should remove the 2020 regulation’s restrictions on including ESG funds as qualified default investment alternatives.28 The Department’s rationale for adopting these restrictions was that the “overriding concern” of ERISA “has always been providing a secure retirement for America's workers and retirees” and that “it is inappropriate for participants to be defaulted into a retirement savings fund that may have other objectives absent their affirmative decision.”29 This rationale assumes a false dichotomy between a fiduciary’s consideration of climate change and the objective of “providing a secure retirement” for plan beneficiaries. A prudent fiduciary may determine that climate change presents relevant risks and opportunities for a retirement plan, making an investment incorporating ESG an appropriate qualified default investment alternative for that plan.

Finally, the Department should adopt the proposed changes on proxy voting in paragraph (d) of the regulation. As the Department correctly notes in the proposed rule, the 2020 regulation, and in particular the statement in current paragraph (e)(2)(ii), could be read as needlessly discouraging proxy voting by fiduciaries.30

We thank the Department for its consideration of our comments. Please let us know if we can be of any further assistance.

Sincerely,

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28 See 29 C.F.R. § 2550.404a-1(d)(2)(ii) (excluding an investment option as a qualified default investment alternative “if its investment objectives or goals or its principal investment strategies include, consider, or indicate the use of one or more non-pecuniary factors.”).