

EMPLOYEE BENEFITS SECURITY ADMINISTRATION

ANNUAL REPORTING AND DISCLOSURE

ABOUT THE PRI

The United Nations-supported Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment.

Responsible investment is an approach to investment that explicitly acknowledges the relevance to the investor of environmental, social and corporate governance (ESG) factors, driven by recognition in the financial community that evaluation of ESG factors is fundamental to assessing portfolio value and investment performance.

Since 2006, over 1500 investors globally with USD\$60 trillion in assets under management have signed the Principles, committing to including ESG factors in investment decision making, voting and engagement. The US is the PRI's largest market with 273 signatories and USD\$33 trillion assets under management.

We set out below the response by the PRI Executive to the Employee Benefits Security Administration, RIN 1210-AB63.

EFFECTIVE DISCLOSURE OF INVESTMENT PRACTICES

In January 2016, the Principles for Responsible Investment (PRI), the United Nations Environment Programme Finance Initiative (UNEP FI) and The Generation Foundation launched a three-year project to clarify investor obligations and duties in relation to the integration of environmental, social and governance (ESG) issues in investment practice. This follows the publication in September 2015 of [Fiduciary Duty in the 21st Century](#), which found that failing to take account of material ESG issues is a failure of a fund's fiduciary duty.

Throughout 2016, PRI has engaged with actors from across the US capital market to understand key barriers to full incorporation of ESG factors into investment decision-making. This review finds that effective disclosure of investment practices, including ESG factors, helps to ensure that a fund fulfils its fiduciary duties to ultimate beneficiaries.¹

¹ <http://www.fiduciaryduty21.org/country-roadmaps.html>

SUMMARY OF PRI'S POSITION

The proposed rule will improve governance and transparency of employee benefit plans. The rule will ensure employee benefit plans review and report on a comprehensive range of risks, appropriate to the nature, scale and complexity of the plan, and in doing so provide better investment outcomes to plan members. The proposed rule will strengthen and harmonise plan regulation, bringing the US in line with international good practice.

As part of expanded disclosure for ERISA governed plans, the PRI recommends that the Department of Labor request disclosure of the extent to which long-term value drivers, including ESG factors, are incorporated into investment decisions and relations with scheme service providers – such as through asset manager mandates.

The PRI's experience is that plans can embed ESG factors into existing processes, such as manager selection, in a cost-effective and efficient manner. We draw the Department's attention to the PRI's report, *How asset owners can drive responsible investment*,² and forthcoming technical guides for writing investment strategy, policy, and the selection, appointment and monitoring of asset managers.³

BUSINESS CASE FOR INCORPORATION OF ESG FACTORS

The incorporation of environmental, social and governance (ESG) factors into investment processes and research is a critical addition to the analytical tool-kit available to employee benefit plans.⁴ Management of ESG factors can be a source of enhanced operational performance and financial prospects in investee companies.⁵

The PRI defines ESG integration, a strategy for incorporation, as “the systematic and explicit inclusion by investment managers of environmental, social and governance factors into traditional financial analysis”. Neglecting analysis of ESG factors may cause the mispricing of risk and poor asset allocation decisions. It is worth clarifying that ESG incorporation does not necessarily involve a narrowing of the available investment universe (unlike negative screening).⁶ Neither does it involve relegating the pursuit of a financial return to unrelated objectives (social or ethical).

ESG incorporation provides investors with an expanded set of tools for evaluating the operational performance and financial prospects of investee companies. ESG is increasingly assisting investors to identify value-destroying corporate practices undetected by traditional financial analysis.⁷

² https://www.unpri.org/download_report/6385

³ <https://www.unpri.org/about/pri-teams/investment-practices>

⁴ <https://www.sbafla.com/fsb/Portals/Internet/CorpGov/ReportsPublications/SBAValuingtheVote2015.pdf> & <https://www.calpers.ca.gov/page/newsroom/calpers-news/2014/company-performance>

⁵ http://www.hbs.edu/faculty/Publication%20Files/SSRN-id1964011_6791edac-7daa-4603-a220-4a0c6c7a3f7a.pdf

⁶ For some investors, ESG integration is pursued in concert with negative screens.

⁷ <https://www.ft.com/content/b22c49c8-06e8-11e2-92ef-00144feabdc0>

INTERNATIONAL EXPERIENCE

Regulators outside the US have increasingly required statements explaining ESG investment practices, such as the recent requirement by the Financial Services Commission of Ontario (FSCO) that pension funds disclose the extent to which they take account of ESG factors in investment processes. The FSCO notes that the decision to incorporate ESG factors is in line with pension administrators' fiduciary duty to monitor and mitigate risk, and that transparency around the fund's policy is critical information for beneficiaries.⁸ Similar disclosures have also been a feature of UK pensions regulation for a decade.

In June 2016, the European Parliament and Council announced that they had reached political agreement on the revision of the Institutions for Occupational Retirement Provision (IORP) Directive. The Articles of the Directive require IORPs with more than 100 members to make public a Statement of Investment Policy Principles (SIPP) at least every three years, and explain whether and how the investment policy takes ESG factors into account.⁹ Against a background of changes in the pension market – not least the shift from defined benefit to defined contribution schemes and increases in life expectancy – the Directive introduced these requirements to enhance scheme governance, risk management and transparency to members.

For further examples, see PRI's *Global guide to responsible investment regulation*.¹⁰

ERISA FIDUCIARIES

ERISA fiduciaries disclose a broad range of information annually on Form 5500 and are subject to record-keeping provisions. The Government Accountability Office has repeatedly examined the issue of effective disclosure by ERISA governed plans and identified extensions and improvements.

We note that the Department of Labor has recently issued a proposed rule to significantly adjust the format and extent of annual disclosures by ERISA governed plans. The proposed rule is intended to “allow the Agencies and the interested public to monitor a larger number of pension plans and their asset allocations” and “lead to more competition and improved plan performance”.

We welcome this initiative as the beginning of a broader process of expanded scheme disclosure and analysis – by both the Department, participants and plan analysis groups.

We note that Mutual Funds are required to disclose policies and procedures for voting shares in investee companies and their record of proxy votes. Attention is being given to simplifying the comparison of mutual fund voting practices to enable manager ratings to be widely developed. In this, as in other, contexts, disclosure may also drive engagement. By providing for expanded disclosures in a prescribed format, regulators can enable inter-investor comparability and differentiation.

⁸ <https://www.fSCO.gov.on.ca/en/pensions/policies/active/Documents/IGN-004.pdf>

⁹ https://www.unpri.org/download_report/20476

¹⁰ <https://www.unpri.org/about/pri-teams/policy/responsible-investment-regulation>

CONTACT

The PRI has experience in international ESG regulation and has developed a wealth of practical guidance on incorporating ESG factors into investment decision making.

The PRI and UNEP FI will publish a roadmap to identify barriers and propose solutions to the full incorporation of ESG factors into investment decision-making, reflecting the modern interpretation of fiduciary duty.

We would welcome further dialogue on the issues raised in this proposed rule.

For further information, please contact:

- Will Martindale, Head of Policy (will.martindale@unpri.org)
- Brian Tomlinson, Associate Director, Fiduciary Duties (brian.tomlinson@unpri.org)