July 30, 2020

VIA ELECTRONIC SUBMISSION
Office of Regulations and Interpretations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue NW, Room N-5655
Washington, DC 20210
ATTN: DOCKET ID NO. EBSA-2020-0004

Re: Comments on "Financial Factors in Selecting Plan Investments" Proposed Regulation

Dear Sir or Madam:

On behalf of Life:Powered, an energy policy initiative of the Texas Public Policy Foundation, we are writing in support of the EBSA's proposed rule emphasizing the fiduciary duty of ERISA-regulated retirement plans, in particular regarding the recent trend toward environmental, social, and governance (ESG) investing. The documentation for the rule highlights important points about the history of the fiduciary standard under ERISA and the need for clarification, especially following the interpretive bulletin promulgated in 2015 that seemed to allow for broader use of "economically targeted investments", including ESG investments.

This rule is needed to put some guardrails not just around ESG investing but also around any investing trend that is not fundamentally grounded in providing the best financial returns for retirement plan participants. While the rule could go farther in banning these practices outright, it is a step in the right direction. To bolster this argument, we want to expand on what the ESG investing trend likely will and will not accomplish, both for retirement plan participants and for Americans on the whole, and why any fund manager would be hard-pressed to use ESG strategies while not violating their fiduciary duty.

What ESG investing will not accomplish is a more efficient allocation of investment capital or higher returns for retirement plan beneficiaries. A common refrain from ESG advocates is that companies with sound ESG practices are less exposed to regulatory and societal risk and better positioned for future trends, especially in reference to the supposed energy transition away from fossil fuels. However, efficient markets theory says that a company's exposure to future upside or downside risks, to the extent that those factors might increase or reduce the value of its assets or its future cash flows, should already be reflected in its stock price. Even good governance, which is internal to the company and not related to fickle political trends as much as environmental and social factors, will not increase a stock's expected return because that factor should already be reflected in the stock's price.

ESG advocates might argue that the market is not efficiently pricing these risks, but there is not any sound evidence to date that ESG funds outperform the broader market. There is not a reliable enough definition of ESG criteria nor is there a long enough time period of widespread ESG investing to accurately measure performance against the broader market. Studies purporting higher returns or lower volatility for ESG-related stocks or funds are probably missing other explanations for their results. A likely explanation for the outperformance of some ESG funds in recent years has been the poor performance of oil and gas stocks. However, over time, those industry sector trends must balance out.

What ESG advocates are arguing for is that investors should prefer stocks based on characteristics that are not tied to their fundamental economic valuations. If enough investors buy ESG-favored stocks and ESG funds, those stocks might see their prices increase. However, because the underlying value of the stocks have not changed, the expected return of those stocks decreases as more investors buy into them. The result is a price bubble. There are numerous examples of price bubbles due to investor preferences that run counter to fundamental valuations, including internet stocks in the late 1990s and the housing bubble in the late 2000s. ESG investing is prone to creating bubbles in a similar manner.

In summary, financial theory says that the best financial outcome an ESG investor can expect is to match the returns of the broader market while incurring slightly higher portfolio risk due to excluding or underweighting certain stocks. While investors cannot expect higher returns from ESG funds, they can expect higher fees, even from a broad-market index fund that incorporates ESG weighting. ESG funds require more research and management than standard index funds, so their cost base is fundamentally higher. Therefore, while some investors might prefer ESG funds for nonpecuniary reasons, on the whole, they cannot expect ESG funds to deliver higher returns due to higher fees and lower diversification.

Unless an ESG fund has fees that match a comparable non-ESG fund and improves a portfolio's diversification, a fund manager can rarely say they are choosing an ESG fund and not violating their fiduciary duty. That fact is true for any investment strategy that follows investor preferences instead of fundamental company valuations. In that sense, this rule puts up an important signpost for fund managers eager to follow the latest trends and gives retirement plan participants more clarity regarding what their managers can and cannot do.

Having covered what ESG investing likely will not accomplish, we want to add a few comments on what the trend likely will accomplish.

First, the preference of ESG investors toward renewable energy and higher cost energy producers will likely result in higher energy prices. ESG advocates will not often say this directly, but eliminating greenhouse gas (GHG) emissions, absent technologies and efficient market mechanisms for doing so, necessarily involves raising energy prices (or taxes) and reducing energy consumption. By allocating capital away from the most affordable energy sources, ESG investing raises borrowing and capital costs for energy producers and requires them to sell their products at higher prices. ESG reporting requirements or programs to reduce GHG emissions also raise costs and ultimately harm consumers.

U.S. consumers are still demanding energy from a wide variety of sources, most of which are fossil fuels. In fact, over the past decade in which ESG investing has been an active trend, U.S. consumption of fossil fuels has remained unchanged at about 80 quadrillion BTU. The share of total energy from fossil fuels has declined a mere 3%, from 83% to 80%, with new wind and solar energy barely meeting the small growth in U.S. energy demand. U.S. production of fossil fuels has risen 40% in the past 10 years, from 58 to 81 quadrillion BTU. Until the technological and energy market realities change more dramatically, the only effect of ESG investing will be to force U.S. energy producers to incur higher costs and U.S.

consumers to pay more for their energy. Given that one in three U.S. households report being burdened by energy costs, this is a trend that will harm a large group of Americans who can least afford it.

Second, the ESG movement will likely have negative, not positive, environmental impacts on the whole, primarily due to its myopic focus on GHG emissions to the exclusion of other environmental and societal considerations. As stated above, the ESG movement has accomplished next to nothing to meet its goals of reducing our use of fossil fuels or reducing our GHG emissions, while its promotion of wind and solar energy is causing environmental harm. Wind and solar are dilute energy resources, requiring a large amount of land to capture, and renewable energy does not mean unlimited energy. As we expand our production of wind and solar, we will necessarily increase the footprint of our energy production on the land and encroach on wildlife habitat. Furthermore, the machines required to capture wind and solar energy are not renewable. They must be mined, manufactured, and shipped, usually from foreign countries, then replenished every couple of decades.

The ESG movement ignores the historical fact that dense energy resources foster economic prosperity AND environmental quality. Wealthy societies have resources to spend to improve their air and water quality and protect their environment. Developed nations have far superior air quality to poorer nations and the U.S. is leading the way with a 77% reduction in aggregate emissions since 1970 despite increasing its consumption of fossil fuels over that time. Spending scarce resources trying to reduce GHG emissions or pursuing ESG goals means that other environmental and societal goals cannot be pursued. Instead of redoubling their failing efforts to promote wind and solar energy, ESG advocates should focus on providing better energy access to the billions of people around the world who lack reliable electricity and cut down their forests for heat and cooking fuel.

These realities of what the ESG movement will likely achieve and not achieve show that the public and fund managers are being misled about the supposed benefits of ESG investing. While this rule could go further in curtailing the practice altogether, it is a definite improvement. It can also set a good precedent for state and local pension funds, which are not regulated under ERISA but often take their cues from the private retirement fund markets. An example of a sound policy is the investment policy statement of the Employees Retirement System of Texas,

> *ERS' voting of social and environmental proposals will be based solely on enhancing or protecting long-term value to ERS and not on establishing or endorsing social policy. As part of its fiduciary duty, ERS shall consider only those factors that relate to the economic value of ERS' investment and shall not subordinate the interests of ERS' Trust Beneficiaries to unrelated objectives.*

Other pensions would do well to follow this example, and we hope this rule will promote the widespread adoption of similar policies.

Sincerely,
Jason Isaac
Director, Life:Powered
Texas Public Policy Foundation