July 17, 2020

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: Comment on Financial Factors in Selecting Plan Investments Proposed Regulation (RIN 1210-AB95)

Dear Director Canary:

I am writing regarding the notice of proposed rulemaking entitled “Financial Factors in Selecting Plan Investments” (Proposed Regulation). The Employee Benefits Security Administration (EBSA) announced its proposed regulation on June 23, 2020. I would like to formally request that the comment period be extended from 30 to 90 days.

In my legal career, I have represented many retirement plan fiduciaries. I am concerned that this Proposed Regulation will not only be confusing to plan investment fiduciaries, but also detrimental financially to retirement plan participants and beneficiaries.

As you may be aware, Morningstar has recently come out with research showing that US ESG funds “comfortably outperformed their peers in 2019.” (Please see attachment #2.) In addition, the report shows that “[o]ver the past five years, sustainable funds have done well in both up and down markets relative to their conventional peers.”

Speaking with investment experts, there are a number of reasons for this outperformance, and many experts believe considering ESG factors will improve fund financial performance on a long-term basis. I have attached Black Rock CEO, Larry Fink’s, letter to CEOs that explicitly states, “climate risk is investment risk.” As you are aware, Black Rock is the world’s largest asset manager, with over $7 trillion in assets under management as of end-Q4 2019.
I completely understand and agree with the ERISA requirements that fiduciaries act solely in the interest of plan participants and beneficiaries and for the exclusive purpose of providing benefits to their participants and beneficiaries. Again, I understand and agree that to fulfill such obligations, investment fiduciaries must pursue the highest possible economic return for fund participants and beneficiaries. However, requiring fiduciaries to take all material economic risk factors into account in making investment decisions would be impossible if such fiduciaries are also concerned about the DOL questioning and auditing conclusions that an ESG fund might be the most economically beneficial option for a retirement fund. The chilling effect on fiduciaries would be detrimental to pursuit of the highest returns. To definitively take away ESGs as an investment option, again, will hamstring fiduciaries into ignoring fund options that may have the best returns.

By going forward with these new regulations, the DOL is stepping into the role of investment fiduciary. If the DOL was to set forth specific options for all retirement funds, choosing what funds are acceptable, this would be straightforward (though likely neither wise, nor practical). By regulating specific types of funds that are eligible or ineligible for plan investments, and by threatening a close watch on decisions to invest in ESG funds, investment fiduciaries would have to choose between doing what is best for the plan and what is least likely to get them in trouble with the regulatory bodies.

As stated in the Proposed Regulation, “[t]he fundamental principle is that an ERISA fiduciary’s evaluation of plan investments must be focused solely on economic considerations that have a material effect on the risk and return of an investment based on appropriate investment horizons, consistent with the plan’s funding policy and investment policy objectives.” This principle, left alone, will suffice as a guiding principle of investment fiduciaries. It is clear, concise, and follows the language and intent of ERISA. The Proposed Regulation does not clarify this point but puts significant road blocks in its way.

Although I am interested in submitting a more thorough comment on the Proposed Regulation, the current 30-day comment period is insufficient to do so. As I understand from other colleagues as well, pandemic-related issues are preventing many from taking the time needed to put together a fully-researched and supported comment. Please consider providing a 60-day extension for me and other interested parties to submit comments.

Thank you for taking this request into consideration. Please feel free to contact me at lefkowitz100@gmail.com if you have any questions.

Yours very truly,

Ivan M. Lefkowitz, Esq.

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Sustainable funds outperformed their conventional peers in 2019, helped in part by underweighting energy company investments but also by continuing a general trend from recent years of better performance than non-ESG funds. U.S. ESG Funds Outperformed Conventional Funds in 2019

The performance of sustainable funds relative to the fund universe is likely, yet it has happened in each of the past five calendar years. Among sustainable index funds that focus on non-U.S. large caps, 12 out of 13 funds have outperformed their benchmarks over the trailing five years. The returns of only four of these funds ranked in the bottom quartile. While the five-year returns of the older sustainable funds rank even better relative to their Morningstar Categories, while those of sustainable allocation and alternative funds skewed more positively. Overall, rather than their returns being distributed evenly within their respective categories, the returns of sustainable equity funds skewed more evenly toward the top half, with the returns of two thirds landing in the top half and only 12% in the bottom half. The returns of sustainable fixed-income funds in 2019 were more or less average for their categories and clustered into the middle two quartiles, with the returns of only 16% placed in the bottom quartile and 33% in the top quartile. Sustainable equity funds did even better, with the returns of 41% ranking in the top quartile, compared with 23% of all equity funds. Of the 588 U.S. equity funds with full-year records, 155 placed in the top quartile for the trailing five years. Moreover, all of the top-quartile sustainable funds (23 of 45) beat the S&P 500 for the year. That is a 51% “beat rate,” twice that of large-blend funds and five times that of large-cap growth funds. The returns of 84% of the top-quartile funds ranked in the top half of their categories, compared with only 38% of all U.S. equity funds. Sustainable large-blend funds turned in an overall top-quartile rate of 88%, and as a group, sustainable large-blend funds turned in an overall top-half rate of 94%. Over the longer periods, nearly half of the 33 sustainable large-blend funds have more than five years of performance history, compared with 55% of all large-blend funds and 62% of large-cap blend funds. Sustainable large-blend funds have delivered outperformance in both up and down markets relative to their conventional peers. When markets were up in 2016 (2015) or down (2018), the returns of 57% and 63% of sustainable funds placed in the top half of their categories. When markets were flat (2017), 60% of sustainable funds outperformed their peers. They did especially well in 2018, when the S&P 500 returned -6.45%—Sustainable funds returned 12.30%, or 18.75% more than the market, a 58% “beat rate.”

The performance of sustainable funds across categories.

Tech strength: sustainable funds put some of their extra performance into the information technology sector, just about the same as the S&P 500’s 24.2% return. Among diversified sustainable U.S. equity funds, 12% of the 38 funds with full-year records have more than 10% of their assets in technology stocks, compared with 11% of all equity funds. The performance of the technology sector was a major tailwind for the performance of these funds, but the sector also contributed substantially to the performance of most funds in the S&P 500. The performance of sustainable funds relative to the fund universe seems to be a function of the information technology weighting.

The performance of diversified sustainable U.S. equity funds have an average 23.9% weighting to the technology sector, compared with 14.1% of all equity funds. The performance of US growth funds is a factor: The weighting of the information technology sector in US growth funds is much higher on average (38.4%) than in US blend funds (19.5%) or US value funds (15.2%). The returns of US growth funds have outperformed US blend and US value funds in all three of the past five years, while US value funds have outperformed the S&P 500 just once. The performance of US growth funds is highly correlated with the performance of the technology sector, so it is no coincidence that the performance of sustainable funds relative to the S&P 500 is also highly correlated with the performance of the technology sector. The information technology sector is the biggest contributor to the performance of sustainable funds relative to the S&P 500. For the diversified sustainable U.S. equity funds, performance gains relative to the S&P 500 are concentrated in the technology sector, which could be responsible for their relative outperformance. But the performance of sustainable funds relative to the fund universe is the difference alone, however, does not explain the relative outperformance of sustainable funds across categories.

The performance of sustainable funds was consistently better during periods of market volatility. Sustainable funds were strong in both up and down markets. Over the trailing five years, 55% of diversified sustainable U.S. equity funds placed in the top half of their categories. When markets were up in 2016, 57% of sustainable funds placed in the top half of their categories. When markets were down in 2018, 63% of sustainable funds placed in the top half of their categories. When markets were flat in 2017, 60% of sustainable funds placed in the top half of their categories. Overall, sustainable funds have outperformed their peers in 2019. The returns of the 44 U.S. diversified sustainable equity funds have an average 23.9% weighting to technology, which could be responsible for their relative outperformance. But the performance of sustainable funds relative to the fund universe is the difference alone, however, does not explain the relative outperformance of sustainable funds across categories.

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