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The Honorable Jeanne Klinefelter Wilson  
Acting Assistant Secretary  
U.S. Department of Labor  
Employee Benefits Security Administration  
200 Constitution Ave NW  
Washington, DC 20210

**RE: Notice of Proposed Rulemaking on Financial Factors in Selecting Plan Investments Amending “Investment duties” Regulation at 29 CFR 2550.404a-1 (RIN 1210-AB95)**

Dear Assistant Secretary Wilson:

On behalf of a group of our clients who provides a broad array of administrative and investment services to retirement plans (the “Group”), we are submitting comments on the Department of Labor’s (the “Department”) proposed rule “Financial Factors in Selecting Plan Investments” (the “Proposed Rule”). We appreciate the Department’s efforts to comply with the President’s Executive Order by escalating its views on the consideration of environmental, social, and governance (“ESG”) factors from sub regulatory guidance and to notice and comment rule making. We also appreciate the Department’s efforts to define the duty of loyalty that plan fiduciaries are subject to when making investment decisions. We submit this comment letter in the hope that the final rule, when issued, will take our comments into account.

**A. Introduction**

As discussed more fully below, the Group encourages the Department to replace its new, expansive, five factor articulation of the duty of loyalty with a simple clarification stating that “a fiduciary may not subordinate the interests of participants and beneficiaries as retirement savers to any other interests of the participants, beneficiaries, the fiduciary itself or any other party.” We believe that this succinctly captures the duty of loyalty and would cover all relevant scenarios, including a fiduciary’s consideration of investments with an ESG orientation.

Second, the Proposed Rule’s premise that ESG factors are “non-pecuniary” considerations in investment decision-making is flawed. This position does not take into account

substantial evidence that supports the proposition that ESG factors are generally pecuniary and that consideration of these factors will frequently have a favorable long term financial impact. Asset managers and fiduciaries do not rely on ESG factors for ideological reasons, but rather the incorporation of ESG metrics into investment processes is often used to evaluate the financial (pecuniary) risk/reward associated with an investment.

Similarly, the Department's standard under section (c)(3) of the Proposed Rule amounts to a burden shifting that is unsupported by the text of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") section 404. Under the Department's Proposed Rule, fiduciaries that include ESG oriented investments within plans will be presumed imprudent unless they can otherwise prove that the selection comports with the Proposed Rule. This places plan fiduciaries in an untenable position. Thus, we suggest the Department state that there is no special treatment for investment courses of action that include ESG factors and that instead, all investment decision-making must be made on the basis of the general rule described above.

The Department's cost-benefit analysis is also incomplete. The Department has not adequately accounted for the time and effort that will be associated with implementing the Proposed Rule by stakeholders across the industry. The Department's cost-benefit analysis also fails to evaluate the impact of the Proposed Rule on plan investment decisions and the potential added risks that the Proposed Rule could encourage plan fiduciaries to accept.

Finally, the Department should cease its enforcement efforts related to ESG until any final rule is issued. This regulatory effort is itself clear evidence that the Department recognizes that it has no binding guidance related to when a fiduciary may consider ESG factors. Without clear guidance in the form of notice and comment rule making or statutory text, the Department has no enforcement authority or even investigatory authority under ERISA Sections 502 and 504. While the Department may have internal views on the use of ESG factors within retirement plans, it has not shared them in a manner that is legally binding.

**B. ERISA's General Duty of Loyalty**

- i. ERISA's duty of loyalty should prohibit a fiduciary from subordinating the interests of participants and beneficiaries as retirement savers to any other interests of the participants, beneficiaries, the fiduciary itself or any other party.*

Section 404 of ERISA requires a fiduciary to discharge its duties solely in the interest of participants and beneficiaries, for the exclusive purposes of providing benefits and defraying reasonable expenses and with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. The Department first issued regulations interpreting a fiduciary's investment duties more than 40 years ago in its

“Investment Duties” regulation.<sup>1</sup> In the original Investment Duties regulation, the Department provided insight into the duty of care required by ERISA Section 404. The Group supports language in the Proposed Rule specifically enumerating how the Department now seeks to define the duty of loyalty.

The Group agrees that the duty of loyalty requires that a fiduciary “not subordinate the interests of the participants and beneficiaries to the fiduciary’s or another’s interests...”.<sup>2</sup> The Securities and Exchange Commission (“SEC”) has released similar guidance in “Regulation Best Interest”.<sup>3</sup> And, the Department’s articulation of the duty of loyalty is also aligned with its fiduciary advice exemption that was also recently proposed.<sup>4</sup> We agree that the Department should clarify that ERISA’s duty of loyalty is consistent with the standard described under Regulation Best Interest, and other similar standards of care. Retirement savers benefit from the harmonization of the standards of care as it reduces the possibility of investor confusion and uncertainty.

The advantage of the phrasing that we are proposing is that it creates an easily understood, one-part, test that captures both elements of the Proposed Rule. Fiduciaries should focus on participants and beneficiaries “as retirement savers.” This phrase is sufficient to address the Department’s ESG concerns without the need to resort to the adoption of special rules for “pecuniary factors” and other rules for “non-pecuniary factors” and the inference that one can only act prudently and loyally by following a prescribed process. At the same time, the Group’s proposed phrasing captures the Department’s message that a loyal fiduciary does not subordinate a participant’s interest to anyone else’s interest.

- ii. *The remainder of the language in proposed Section 404a-1(b) should be stricken from any final regulation*

Problematically, under the Proposed Rule the Department has offered a longer and circular definition of the duty of loyalty. Section 404a-1(b) is circular because it includes compliance with the duty of loyalty as an element of complying with the duty of loyalty. The addition of phrase “the duty of loyalty” inside the definition of the duty of loyalty creates an invitation for courts to graft on additional responsibilities not included within either the Department’s rule or section 404(a)(1)(A) of ERISA. Similarly, the Department should not have multiple prongs stating that a fiduciary “should not subordinate” and “should not otherwise subordinate.” Section (b)(iii) of the Proposed Rule should be stricken as it is consumed by

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<sup>1</sup> 44 Fed. Reg. 37,255 (June 26, 1979).

<sup>2</sup> 2550.404a-1(b)(iv).

<sup>3</sup> Securities & Exchange Commission, *Regulation Best Interest Small Business Compliance Guide*, <https://www.sec.gov/info/smallbus/secg/regulation-best-interest> (Last Visited 7/15/2020).

<sup>4</sup> *Improving Investment Advice for Workers and Retirees*, 85 Fed. Reg. 40834 (Jul 7, 2020).

(b)(iv). Finally, Section (b)(v) should be stricken because it is superfluous. No court has found that a fiduciary acted prudently and loyally where the fiduciary disregarded the outcome of a prudent process.

### C. ESG and Pecuniary Factors

Under the Proposed Rule, the Department notes that “Environmental, social, corporate governance, or other similarly oriented considerations are pecuniary factors only if they present economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories.”<sup>5</sup> Under this framework, it is unclear whether an investment selected in part for an ESG-compliant factor would presumptively be deemed in violation of ERISA section 404 even where the investment is otherwise prudent from a risk and return perspective or the ESG-themed attribute is in furtherance of pecuniary factors. The Department should eliminate all portions of the Proposed Rule that are specific to the consideration of ESG factors because of the significant flaws in its analysis.

#### i. ESG factors can be “pecuniary factors”

The Proposed Rule erroneously suggests that investment courses of action that consider ESG factors are problematic because ESG factors are essentially non-pecuniary. The Proposed Rule does not take into account substantial evidence that would support the position that ESG factors can be pecuniary, and fails address or evaluate recent GAO and the Department reports that come to the opposite conclusion.<sup>6</sup>

Additionally, industry consensus has emerged that a majority of ESG funds outperform the broader market across all asset classes for a variety of reasons.<sup>7</sup> In order to provide consistency and to ensure that fiduciaries are empowered to make decisions based on all pecuniary factors, the DOL should remain consistent with their repeated past statements that fiduciaries need not treat commercially reasonable investments as suspect simply due to the

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<sup>5</sup> 29 CFR Part 2550 RIN 1210–AB95 (Proposed Rule) at (c)(1).

<sup>6</sup>United States Government Accountability Office, *Retirement Plan Investing*, <https://www.gao.gov/assets/700/691930.pdf> (Last Visited 7/15/2020).

<sup>7</sup> Financial Times, *Majority of ESG funds outperform wider market over 10 years*, <https://www.ft.com/content/733ee6ff-446e-4f8b-86b2-19ef42da3824> (Last Visited 7/15/2020); Morningstar, *US ESG Funds Outperformed Conventional Funds in 2019*, <https://www.morningstar.com/articles/973590/us-esg-funds-outperformed-conventional-funds-in-2019> (Last Visited 7/15/2020); The Wall Street Journal, *ESG Investing Shines in Market Turmoil, With Help From Big Tech*, <https://www.wsj.com/articles/esg-investing-shines-in-market-turmoil-with-help-from-big-tech-11589275801> (Last Visited 7/15/2020).

nature of the investment. In this regard, the Department's position on ESG is inconsistent with positions the Department has published as recently as last month. In an information letter, the Department stated, "[W]hether a particular fund or investment alternative satisfies the requirements set forth in sections 403 and 404 of ERISA is an inherently factual question upon which the Department will not issue opinions."<sup>8</sup> The Department contradicts that longstanding position in the Proposed Rule, and posits that for funds that contain ESG components, whether an investment alternative satisfies the requirements set forth in ERISA is *not* an inherently factual question. Instead, ERISA fiduciaries are considered imprudent and disloyal for considering such factors unless they can prove otherwise. The text of ERISA does not treat ESG oriented investments differently than other investments and the Department should not do so here.

ESG integration within the portfolio management process is not driven by ideological considerations. Instead, ESG is integrated within investment portfolios to improve the client's risk/reward profile -often by eliminating unnecessary risk. It is important for fiduciaries and asset managers to evaluate the litigation, regulatory, operating, reputational and market risk of companies when investing ERISA plan funds. Those factors constitute a significant component of an investment's risk/reward profile. And, the risks identified above are fundamental to the analysis of whether an investment presents an appropriate and prudent investment opportunity. Moreover, an asset manager's ability to evaluate these characteristics is an important part of its overall value proposition. Because the Proposed Rule suggests that taking these factors into account would be a violation of ERISA, it will cause plan fiduciaries to avoid investment that consider these characteristics, thereby potentially increasing the risk associated with plan investments.

All too often ESG risks that appeared immaterial prove to have significant economic consequences. And, because prudence is judged at the time an investment decision is made, the Department should not penalize fiduciaries who identify a real risk factor albeit one that considers one or more ESG factors, even if losses from that risk fail to materialize.<sup>9</sup> In our Group's view, the Proposed Rule should recognize that ESG consideration can be seen as a risk-mitigation tool and that the exclusion of these factors could result in unbalanced risk-taking to the detriment of retirement savers.

Main Street retirement investors recognize the economic impact of ESG factors every day where, for example, they decide between buying or renting real estate near a body of water or

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<sup>8</sup> DOL Information Ltr. To Jon Breyfogle (Jun 3, 2020).

<sup>9</sup> See *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, 425 (2014) (internal quotation marks and citation omitted); See also *DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 424 (4th Cir. 2007).

next to a chemical facility. Investment trends change and while a qualified investment professional today might conclude that beachside real estate is a better investment, tomorrow's investment professional may reach the opposite conclusion. Enabling investment fiduciaries to ask if there is an ESG factor that materially impacts an investment opportunity will allow fiduciaries to react to fast moving trends or to take advantage of commonly held misperceptions.

While the above example focused on environmental factors, the point could just have easily been made using governance or social factors. In the public equities space, governance concerns are almost always pecuniary. For example, a leading global equities private index company has recognized the "governance" prong of ESG as covering a broad range of corporate activities including board and management structures, decision-making processes, and accounting practices.<sup>10</sup> Focusing on governance has long been a key part of Warren Buffett's investment strategy with 'yardstick of management' being his preferred term.<sup>11</sup> As governance has long been understood to have a significant impact on performance and is a key factor for some of the leading asset managers of the past 50 years, the Proposed Rule's discouragement of its consideration may in fact undermine long-term investment performance.

While the Department may be skeptical that certain factors will ever have a material economic impact, the Department should leave that determination to plan fiduciaries and not attempt to steer their consideration of certain types of investments by amending regulations under ERISA section 404.

- ii. *Paragraph (c) of the Proposed Rule should be stricken. Section 404 requires fiduciaries to do what an expert in a similar situation would do and not merely follow a process blessed by the Department.*

The Group urges the Department to remain consistent with its prior guidance on the duties of loyalty and prudence. For over forty-five years, plan fiduciaries have been subject to ERISA's twin duties of prudence and loyalty irrespective of the type of investment selected. Moreover, ERISA is flexibly tailored to permit plan fiduciaries to satisfy their obligations under ERISA sections 403 and 404 without special rules enumerating how plan fiduciaries can carry out their responsibilities for any particular type of investment. This guidance has served both plan sponsors and plan participants well.

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<sup>10</sup>MSCI Incorporated, *The MSCI Principles of Sustainable Investing*, <https://www.msci.com/documents/10199/16912162/MSCI-ESG-House-View-FINAL.pdf/63bba1a1-aecf-ba80-aa49-7910748ed942?t=1579587918450> (Last Visited 7/15/2020).

<sup>11</sup> CNBC, *Warren Buffett on judging management*, <https://www.cnbc.com/2018/05/08/warren-buffett-heres-how-to-judge-management.html> (Last Visited 7/15/2020).

The Proposed Rule unnecessarily limits the flexible application of ERISA's fiduciary standards by espousing specific rules for the use of ESG and socially-oriented investments in ERISA covered plans. The Proposed Rule also creates a presumption that plan fiduciaries who invest in ESG oriented investments have violated ERISA sections 403 and 404 unless there is documentation that the ESG factors were not taken into account in the determination of whether to offer the investment option. In this regard, section (c)(iii) of the Proposed Rule provides that a fiduciary's addition of an ESG oriented investment alternative within a defined contribution plan would not violate ERISA's section 403 and 404 provided that: (a) the plan fiduciary evaluates the investments solely using objective risk and return criteria, (b) the plan fiduciary documents their decision, and (c) such ESG oriented investments are not included as part of a plan's QDIA.

The Proposed Rule, as written, places plan fiduciaries in an untenable position. This new framework essentially shifts the burden of proving compliance and creates a presumption that plan fiduciaries have acted imprudently when selecting ESG oriented investments. Without more clarification, the rule as written appears to require plan sponsors and other fiduciaries to comb through every single factor considered by their investment professionals and make sure that none of them can be considered ESG oriented, to avoid a plan's fund selection process being considered presumptively imprudent. This undermines the plain text of ERISA section 3(38) and the well established non-plan asset status of mutual funds because it requires plan fiduciaries to look through to the underlying holdings on a seemingly real-time basis. Moreover, plan fiduciaries would be deemed liable for the selection or monitoring of investments simply because they failed to document the decision-making process in accordance with the Proposed Rule. The Group strongly urges the Department to remain consistent with ERISA, long-established case law, the Department's own prior guidance, and the practical time and monetary constraints of fiduciaries by clarifying that plan fiduciaries are subject to ERISA's twin duties irrespective of the type of investment selected.

Similarly, sections (c)(1) and (c)(2) should be stricken because each would be covered by our suggested changes to section (b). The Department does not add further clarification by defining "pecuniary factors" nor does it help plan participants when it creates new rules governing "economically indistinguishable investments." If a fiduciary is picking between economically indistinguishable investments, rather than engaging in additional process and recordkeeping, a prudent fiduciary would come up with a reason to pick one (even if it is not plan related) and move on. The retirement system is not improved if the Department paralyzes fiduciaries when they encounter ties.

Thus, the Group recommends that section (c) be removed and the Department instead simply provide that plan fiduciaries may not subordinate the interests of participants or beneficiaries to any other interest as we further described above. If Congress wants to create favored or disfavored types of investments, it can do so. It did not do so in ERISA and the Department should not support this kind of investment approach.

*iii. The Department's regulatory impact analysis is incomplete.*

Not only are the Department's efforts to further regulate ESG investments misguided, but the cost of compliance will significantly drive up plan costs far beyond those estimated by the Department under its cost-benefit analysis. At the most basic level, the Proposed Rule would drive up plan investment costs by requiring plans to engage financial professionals to review their line-ups and default options to determine if any options or components of options include "non-pecuniary" factors in their investment decisions. Similarly, each subsequent investment decision made by plans would require a detailed evaluation of whether any option or component of an option include "non-pecuniary factors" that are prohibited by the Proposed Rule. The costs to perform these tasks do not exist today. These costs would apply to every ERISA covered plan, not just those contemplating an investment option or course of action with an explicit ESG orientation. Even beyond the added costs associated with constant evaluation of plan investment lineups, the Department's current regulatory impact analysis misses other ways that the Proposed Rule would financially harm plans and their participants.

By imposing new recordkeeping and "materiality" requirements on plan fiduciaries, the Proposed Rule would stifle innovation and would in essence require a herd mentality when evaluating investments. As a result, we can envision retirement plans and participants being subjected to significant "black swan" events where plans and participants will incur significant investment losses before new ESG factors are considered material.

In this regard, the Department's regulatory impact analysis is flawed because it fails to recognize that ESG factors can be seen as an insurance policy. In the short term, the Department may be correct that fees related to ESG screens may be avoided and that by ignoring the long-term risk of ESG factors, investors may be able to obtain short-term gains. However, the Department's regulatory impact analysis should not assume that the world will remain as it is today.

**D. DOL's Enforcement Activity.**

While not part of this regulatory proposal, we are aware that the Department has initiated enforcement efforts related to the use of ESG within retirement plans. We recommend that the Department cease its enforcement efforts related to ESG immediately.

Any current enforcement of ESG within retirement plans is rooted under Field Assistance Bulletin ("FAB") 2018-01. FAB 2018-01 is not a regulation and was not subject to notice and comment rulemaking, thus making it non-binding guidance under the Administrative Procedure Act ("APA").<sup>12</sup> To comply with law, the Department should cease investigating the use of ESG

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<sup>12</sup> 5 U.S.C. § 553

factors until it has issued final binding rules that comply with the APA.<sup>13</sup> We are concerned that the Department is on notice that some of its ongoing enforcement initiatives fail to comply with Supreme Court precedent and orders from the President. To the extent the investigations are fact-gathering exercises to assist with rulemaking, ERISA sections 502 and 504 are not tools for rulemaking. Instead, the Department can issue RFIs or ask the ERISA Advisory Council for assistance. In any event, the initiation of ESG enforcement initiatives at this time is premature.

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In summary, we appreciate the effort put forth by Department staff and we hope the Group's comments will help the Department formulate a final Rule that benefits plan participants and beneficiaries as well as the retirement investment providers who serve them. We would be happy to have future discussions with the Department on this matter.

Very truly yours,



Stephen M. Saxon

Cc: George M. Sepsakos  
Kevin L. Walsh  
Thomas Roberts  
David C. Kaleda

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<sup>13</sup> *Kisor v. Wilkie*, 139 S. Ct. 2400, 2420 (2019) (“An [agency’s] enforcement action must . . . rely on a legislative rule, which (to be valid) must go through notice and comment.”) (Kagan, J., plurality). *See also*, Executive Order Nos. 13891 and 13892.