

Chris Netram

Vice President,
Tax and Domestic Economic Policy

July 30, 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: RIN 1210-AB95: *Financial Factors in Selecting Plan Investments*

To whom it may concern:

The National Association of Manufacturers appreciates the opportunity to provide comments to the Department of Labor on RIN 1210-AB95, the Employee Benefits Security Administration's proposed rule on Financial Factors in Selecting Plan Investments.¹

The NAM is the largest manufacturing trade association in the United States, representing manufacturers of all sizes and in all 50 states—and the millions of men and women who make things in America. More than two-thirds of manufacturing workers participate in a workplace retirement plan.² These employees depend on sound investment decisions made on their behalf for a secure retirement.

The sole duty of plan managers making investment decisions in both defined benefit and defined contribution pension plans is to provide long-term returns that will support millions of manufacturing workers and their families in their retirement years. As such, the NAM appreciates that the DOL has promulgated a rule proposal reiterating that fiduciaries under the Employee Retirement Income Security Act have an obligation to act solely in the interest of plan beneficiaries and for the exclusive purpose of providing benefits to participants and their families. While this “eye single” standard is not new,³ the recent rise in the popularity of investing based on environmental, social, and governance factors that may or may not be related to a participant's long-term financial best interests highlights the need for enhanced clarity from the DOL on fiduciaries' duties of prudence and loyalty when selecting plan investments.

NAM members are making significant strides in combatting climate change, protecting workers, promoting diversity, and striving for justice and equality. Across the manufacturing industry, companies are adopting ESG policies and providing ESG disclosures to investors that are appropriate for their businesses and important to shareholders. Moreover, the NAM strongly supports individual investors' ability to bolster their own social values via their portfolios—both through their own personal investments and through their fund choices in defined contribution

¹ *Financial Factors in Selecting Plan Investments*, 85 Fed. Reg. 39113 (30 June 2020). RIN 1210-AB95, available at <https://www.govinfo.gov/content/pkg/FR-2020-06-30/pdf/2020-13705.pdf>. Hereinafter, “proposed rule.”

² *National Compensation Survey: Employee Benefits*. Bureau of Labor Statistics, March 2018. Available at <https://www.bls.gov/ncs/ebs/benefits/2018/ownership/private/table02a.pdf>.

³ See, e.g., *Donovan v. Bierwirth*, 680 F.2d 263,271 (2d. Cir. 1982).

pension plans. Individuals are free to pursue ESG investments that align with their values, including in instances where an ESG fund might not prioritize financial returns.

The DOL's rule proposal focuses only on decisions made by ERISA fiduciaries on plan participants' behalf, where enhancing financial returns is their sole legal obligation. In the fiduciary context, ESG investing raises significant concerns—and carries the risk that hard-working Americans could see their retirement funds diverted in service of a plan manager's political goals. Individual companies are free to pursue appropriate ESG agendas for their businesses, their communities, and their shareholders, and individual investors and plan participants are free to select funds that match their ESG values—but ERISA fiduciaries cannot select investments based on non-pecuniary ESG factors when plan participants' retirement savings are at stake. The NAM encourages the DOL to finalize a rule that reflects this reality and protects millions of manufacturing workers who will depend on their pensions for a secure retirement.

I. Considering Pecuniary ESG Factors

At the outset, it is important to distinguish between an individual's decision to choose an investment based on its alignment with their personal values and a plan manager's decision to impose their values on all of a plan's participants. Individuals are free to align their investment choices with their values and to weigh their own financial returns against the social good that they believe an investment might engender. That is one reason why the NAM strongly believes that participant-directed defined contribution plans should continue to be empowered to contain ESG-focused investments as options for plan participants alongside more traditional investment vehicles.⁴ ERISA fiduciaries managing defined benefit plans, on the other hand, cannot conduct a similar weighing exercise, pitting their own social values against the financial returns of the plan.

However, ESG factors may be material to an investment or an investment course of action, and the NAM appreciates that the proposed rule is explicit that in such instances an ERISA fiduciary can, and should, consider those factors in determining how to act in plan beneficiaries' best interests. The proposed rule gives the example of a company disposing of hazardous waste in contravention of safety standards, giving rise to layers of business, regulatory, and legal risk. Provided these concerns are appropriately weighted, an ERISA plan manager should be able to conduct a fulsome risk-benefit analysis incorporating the risks presented by such a company's actions in deciding whether and how to invest in its securities. Such an analysis would clearly be in service of "the paramount, and eminently-worthy, 'social' goal of ERISA plans"—maximizing the funds available to pay retirement benefits for American workers.⁵ Other social objectives need not, and must not, be considered when plan beneficiaries' retirement security is on the line.

The NAM appreciates that the proposed rule acknowledges that "ESG factors and other similar considerations may be economic considerations"⁶ and provides guidance to ERISA fiduciaries in how to consider pecuniary ESG factors when contemplating an investment decision. The rule highlights the importance of understanding the "economic risks or opportunities" attached to such considerations in order to understand their material impact.⁷ It also encourages fiduciaries to

⁴ As discussed in more detail below, these investment choices should still be selected with appropriate due diligence by plan managers and should include appropriate disclosures of the funds' objectives and strategies. And we do not believe that an ESG investment should be the default fund into which all participant assets are directed. Nevertheless, we strongly believe in investor choice, and in defined contribution plans facilitating employees' wishes to consider ESG investment options.

⁵ Proposed Rule, *supra* note 1, at 39116.

⁶ *Id.* at 39117.

⁷ *Id.* at 39127.

appropriately weight pecuniary ESG factors based on “a prudent assessment of their impact on risk and return” alongside other relevant economic factors necessary to make an investment decision.⁸ This guidance will protect plan participants by ensuring that ERISA fiduciaries are making reasoned investment decisions based on all material information, including pecuniary ESG factors, available to them.

II. Impact of Non-Pecuniary ESG Investing on ERISA Beneficiaries

As the proposed rule notes, investing based on non-pecuniary ESG factors “raises heightened concerns under ERISA.”⁹ Many ESG-focused funds have a stated goal of subordinating investor return or increasing investor risk for the purpose of achieving political or social objectives. These funds also often assess higher management fees. ERISA fiduciaries’ duty of loyalty, on the other hand, requires that they act with a “single-minded focus” on beneficiaries’ long-term best interests.¹⁰ These two priorities—chasing social good (often at higher cost) versus bolstering retirement security—are in many instances orthogonally opposed to one another, as evinced by many ESG funds’ disclosures highlighting the potential for reduced returns, increased risks, and heightened fees in service of social goals.

Moreover, the political values in question are those of the plan manager rather than the views of any particular plan participant, or the participants as a whole. ESG investing decisions in the ERISA context involve the prioritization of plan managers’ political goals over the views of plan participants that may or may not hold the same values, as well as the subordination of the participants’ retirement savings in service of political pursuits. As such, ERISA fiduciaries must forgo consideration of any non-pecuniary factors, including ESG considerations that are not material to the investment in question, when contemplating investment decisions. Instead, fiduciaries should conduct an analysis “focused solely on economic considerations that have a material effect on the risk and return of an investment.”¹¹

In addition to running counter to the foundational principles of an ERISA fiduciary’s relationship to ERISA plan participants and beneficiaries, investing based on non-pecuniary ESG factors is opposed by Americans saving for retirement. A recent survey conducted by Spectrem Group found that 91% of retail investors prioritized maximizing investment returns over pursuing other social or political initiatives.¹² Pension plan participants agree to a compensation package predicated on the assumption that their pension will be there for them when they retire, and they expect their ERISA fiduciaries to take steps to protect their retirement savings during their working years.

Given the clear legal standards applicable to ERISA fiduciaries, and plan participants’ stated interest in prioritizing returns in their retirement accounts, the NAM applauds the DOL for making it explicit that plan managers “must never sacrifice investment returns, take on additional investment risk, or pay higher fees to promote non-pecuniary benefits or goals.”¹³ This important clarification will resolve the uncertainty caused by years of evolving sub-regulatory guidance and will ultimately protect the retirement savings of manufacturing workers and their families.

⁸ *Ibid.*

⁹ *Id.* at 39115.

¹⁰ *Id.* at 39116.

¹¹ *Ibid.*

¹² *Reclaiming Main Street: SEC Hears Retail Investors’ Cries for Proxy Advisory Oversight*. Spectrem Group, January 2020. Available at https://spectrem.com/Content_Whitepaper/white-paper-reclaiming-main-street.aspx.

¹³ Proposed Rule, *supra* note 1, at 39116.

III. ESG Standards and Ratings

The NAM believes strongly in the importance of managing the risk of climate change, ensuring clean air and water, increasing workplace diversity, promoting justice and equality, and addressing many of the other issues often highlighted by ESG investing criteria. Indeed, manufacturers across the industry have taken proactive steps to implement ESG policies suitable for their businesses and their investors, and to disclose any material ESG information, data, or risk factors that might impact an investing decision.

Yet despite these good-faith efforts, manufacturers often face calls from third-party actors (which do not have a stake in the business nor any interest in shareholders' long-term returns) to address ESG issues in a one-size-fits-all way that meets only the political needs of outside activists. In recent years, this pressure has been driven in large part by ESG ratings firms that have a financial interest in ensuring more widespread adoption of non-pecuniary ESG investing criteria. These firms operate by boiling a complex issue (or, often, multiple complex issues) down into a single numerical score or letter grade with little to no disclosure as to how such score or grade is calculated, nor its impact on shareholder value creation. These one-size-fits-all standards do not take into account the individual circumstances of a given company nor provide any context for a company's ESG work outside of the check-the-box approach favored by the ratings firms. Furthermore, it is often unclear to issuers and investors alike exactly what data went into calculating a given rating.

Pension plan managers making investment decisions based on these ratings are staking plan participants' retirement savings on the opinions of unregulated, nontransparent entities that have no obligation to make decisions in pensioners' best interests. The NAM has called for the Securities and Exchange Commission to provide for effective oversight of ESG raters,¹⁴ and we strongly support the DOL's guidance that ERISA fiduciaries should be "skeptical" of ESG ratings systems.¹⁵ Similarly, we appreciate that the proposed rule highlights the fact that ESG ratings firms "typically emphasize tick-the-box policies and disclosure levels, data points unrelated to investment performance, and/or backward-looking negative events with little predictive power."¹⁶ The misleading marketing practices and one-size-fits-all methodologies of these unregulated firms should not be allowed to influence ERISA beneficiaries' retirement security.

IV. Defined Contribution Plan Participants

The NAM strongly supports the ability of plan sponsors to allow defined contribution plan participants to choose investments that align with their family's financial goals and/or social values. The proposed rule is correct that selecting an investment option in a defined contribution plan does not involve the same trade-offs as directing plan assets toward one investment (and therefore not another) in a defined benefit plan. The DOL should maintain that distinction in the final rule in order to protect plan sponsors that want to be responsive to participants' desires for ESG investing options while still fulfilling their fiduciary obligations.

As part of a "prudently constructed lineup of investment alternatives," one or more ESG-themed investment vehicles can provide beneficiaries with an appropriate outlet to use their own savings in pursuit of social goals.¹⁷ Inclusion of these funds should not be required of any ERISA plan, and plan managers should not be subjected to pressure to include ESG investments that may not meet

¹⁴ NAM Comments on SEC File No. S7-22-19, 3 February 2020. Available at <https://www.sec.gov/comments/s7-22-19/s72219-6735396-207626.pdf>.

¹⁵ Proposed Rule, *supra* note 1, at 39118.

¹⁶ *Id.* at 39115.

¹⁷ *Id.* at 39119.

appropriate financial standards for plan beneficiaries. As the proposed rule notes, the actions of fiduciaries in defined contribution plans must still be guided by participants' long-term financial best interests. However, prudently selected ESG investments in many instances may be appropriate to facilitate plan participants' desire to pursue social investing goals provided that the plan has appropriate due diligence and disclosure measures in place.

Given some ESG funds' propensity for misleading nomenclature or unclear methodologies, the NAM appreciates that the proposed rule makes clear that the selection of ESG funds for the menu of investment options still requires "proper analysis and evaluation" on the part of plan managers.¹⁸ "ESG," "green," "sustainable," "responsible," and other similar terms lack clear definitions—and, for that matter, so do each of the "E," "S," and "G" components of "ESG." These descriptors are designed to advertise various investment products and are not necessarily associated with any particular standards for investment objectives, weighting, or returns for plan participants. Plan managers must still conduct an appropriate evaluation if they are to include ESG investment choices in a defined contribution plan fund lineup.

In addition to plan managers' due diligence when selecting potential ESG funds, it is critical that plan participants are given the tools to understand the objectives, constraints, and investment strategies of these funds. A lack of standardization around what it means for a fund to be ESG-focused, combined with many participants' lack of understanding that many ESG funds will forgo returns to achieve political goals, underscores the importance of fulsome disclosure obligations. For instance, SEC Commissioner Elad Roisman in a recent speech noted that it is often unclear to investors whether ESG funds "intend to subordinate the goal of achieving economic returns to non-pecuniary goals, and, if so, to what extent."¹⁹ The NAM believes that ESG investing options are only appropriate for a defined contribution plan if they provide appropriate disclosures that allow plan participants to fully understand their investing choices. These disclosures and other similar protections are critical to ensuring that plan participants that wish to do so can freely choose ESG-themed investments that align with their values.

The NAM does not believe, however, that ESG-themed funds, or funds that consider non-pecuniary ESG factors, should be the qualified default investment alternative for a defined contribution plan. As the proposed rule notes, QDIAs exist to ensure that plan participants that have not made affirmative investment designations for their accounts benefit from a fund designed to meet their long-term retirement savings needs. For most plans, the QDIA will be a target date fund selected based on a participant's age. Plan participants are always free to move assets out of the QDIA (into an ESG fund or otherwise) or to pre-select investments so the plan's choice of a QDIA never impacts their savings. Plan managers choose a QDIA to protect participants who are not comfortable making such investing decisions on their own.

As such, it would not be appropriate for a plan's QDIA to be an ESG fund that sacrifices long-term growth to achieve social or political outcomes that a participant may or may not support. There might be some instances in which a fund designed for long-term growth considers at some level (perhaps via one of its component investments) certain pecuniary ESG factors—but ESG criteria in the context of a QDIA should be subject to significantly heightened scrutiny. The selection of a QDIA should be based solely on pecuniary factors relevant to plan participants' retirement security, and the NAM appreciates that the proposed rule clarifies that ESG funds that do not meet this high standard would not be appropriate for consideration as a QDIA.

¹⁸ *Id.* at 39124.

¹⁹ Roisman, Elad. *Keynote Speech at the Society for Corporate Governance National Conference*, 7 July 2020. Available at <https://www.sec.gov/news/speech/roisman-keynote-society-corporate-governance-national-conference-2020>.

V. Implementation Questions

As noted, the NAM strongly supports the proposed rule’s discussion of ERISA fiduciaries’ obligations when considering plan investments—and NAM members offering pension benefits to their employees expect the new standards to align with their existing efforts to protect their plan participants’ long-term best interests. However, certain clarifications from the DOL are needed to enable fiduciaries to implement the new rule effectively.

- The proposed rule requires a fiduciary selecting an ESG fund as part of a defined contribution plan investment lineup to document “its selection and monitoring of the investment.”²⁰ The NAM respectfully encourages the DOL to clarify that this documentation requirement is designed to ensure that ESG funds are appropriately selected and thus that it only applies to any ESG funds included in the plan lineup. We do not believe that the selection of an ESG investment option should necessitate additional documentation requirements for the other, non-ESG investment options made available to plan participants.
- As previously noted, there is a significant lack of clarity around what constitutes an ESG investment or an ESG factor. In order to bolster plan sponsors’ efforts to protect plan participants and comply with the proposed rule, the NAM respectfully encourages the DOL to clarify which investment options it would deem to be impermissibly ESG-driven. Plan sponsors will continue to focus on making investment decisions based on pecuniary factors for the benefit of plan participants, but a clearer definition of “ESG” would enable them to better comply with certain of the proposed rule’s requirements (e.g., the documentation requirements associated with including ESG funds in a defined contribution plan lineup, or the prohibition on designating a fund that considers ESG factors as the QDIA in a defined contribution plan).
- The NAM agrees with the DOL that it is “rarely, if ever” the case that two investment choices are truly “economically indistinguishable.”²¹ As such, we support the proposed rule’s efforts to discourage ERISA fiduciaries from “improperly find[ing] economic equivalence and mak[ing] decisions based on non-pecuniary factors without a proper analysis and evaluation.”²² However, we would respectfully encourage the DOL to remain mindful of the fact that two investments’ overall economic impact on a plan may be comparable even if the investments’ risk-return profile, fee structure, performance history, and investment strategy are not each literally identical. Applying the “all things being equal” test to investment choices with identical impacts on a plan, rather than only those that are identical in each and every respect (except for asset composition), would more appropriately reflect the process by which ERISA fiduciaries select plan investments.

VI. Proxy Voting

The proposed rule focuses on the factors that ERISA fiduciaries should consider when initially making investments or choosing investment courses of action. However, once an investment has been made, plan managers continue to have fiduciary obligations to prudently manage the investment for the benefit of plan participants. The DOL has made clear that these obligations extend to the exercise of their proxy voting authority.²³

²⁰ Proposed Rule, *supra* note 1, at 39127.

²¹ *Id.* at 39117.

²² *Ibid.*

²³ See, e.g., *Field Assistance Bulletin No. 2018-01*. Employee Benefits Security Administration, April 2018. Available at <https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01>.

As with investment decisions, proxy voting decisions (and/or decisions about whether to submit a shareholder proposal to a company's proxy ballot) should be guided by the long-term best interests of plan participants rather than any non-pecuniary political or social goal.²⁴ ERISA fiduciaries should also utilize appropriate due diligence throughout the exercise of their proxy voting authority, including with respect to any decision to retain a third party, such as a proxy advisory firm, in order to provide research, voting recommendations, or voting execution services.²⁵ The NAM urges the DOL to promulgate a rule clarifying ERISA fiduciaries' obligations in considering proxy votes, proxy proposals, and proxy voting service providers, with an eye toward emphasizing the primacy of plan participants' long-term best interests and protecting their retirement savings.

Notably, the SEC recently issued guidance²⁶ for investment advisers on their duties to investors when utilizing proxy advisory firms, so DOL action in this space would lead to important regulatory alignment between the rules for SEC-registered investment advisers and DOL-regulated ERISA fiduciaries. In conjunction with the recent SEC rule²⁷ bringing oversight to the proxy firms themselves, DOL guidelines for ERISA funds' use of these firms would protect manufacturing workers from their errors, conflicts of interest, one-size-fits-all methodologies, and automatic vote submission practices.

* * * *

The NAM applauds the DOL for proposing a rule designed to provide ERISA fiduciaries with clear guidelines on selecting pension plan investments and to ensure that non-pecuniary ESG factors do not put manufacturing workers' retirement savings at risk. We continue to support efforts to prioritize the financial health of participants in both defined benefit and defined contribution pension plans, and we thank you for your attention to these important issues.

Sincerely,



Chris Netram
Vice President, Tax and Domestic Economic Policy

²⁴ Notably, studies have shown that ESG-driven proxy proposals can in fact destroy shareholder value. See, e.g., *Political, Social, and Environmental Shareholder Resolutions: Do They Create or Destroy Shareholder Value?* Joseph P. Kalt, L. Adel Turki, et al., June 2018. Available at http://www.shopfloor.org/wp-content/uploads/2018/06/nam_shareholder_resolutions_survey.pdf. (This study was commissioned by the NAM.)

²⁵ The NAM has long been concerned about proxy advisory firms' outsized impact on Americans' retirement savings, as well as pension funds' and asset managers' overreliance on these firms despite their significant conflicts of interest, one-size-fits-all methodologies, lack of transparency, propensity for errors, and problematic voting practices. See, e.g., NAM Comments on SEC File No. S7-22-19, *supra* note 14; see also NAM Comments on SEC File No. 4-725, 30 October 2018 (available at <https://www.sec.gov/comments/4-725/4725-4581799-176285.pdf>) and NAM Comments on SEC File No. 4-725, 5 March 2019 (available at <https://www.sec.gov/comments/4-725/4725-5020171-182986.pdf>).

²⁶ *Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers*, adopted 22 July 2020. Release No. IA-5547, available at <https://www.sec.gov/rules/policy/2020/ia-5547.pdf>.

²⁷ *Exemptions from the Proxy Rules for Proxy Voting Advice*, adopted 22 July 2020. Release No. 34-89372, available at <https://www.sec.gov/rules/final/2020/34-89372.pdf>.