



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

Dear Director Canary:

On behalf of Payden & Rygel, thank you for the opportunity to submit comments on the notice of proposed rulemaking entitled “Financial Factors in Selecting Plan Investments” (“Proposal” or “NPR”). Payden & Rygel is committed to integrating environmental, social and governance (ESG) factors into our investment activities because we believe that ESG integration is essential to fulfil our fiduciary obligations to engage in appropriate risk management. We believe that the NPR misconstrues ESG integration and would lead to confusion and costs for retirement plan fiduciaries. We, therefore, urge you to allow the existing guidance to remain in effect and not move forward with a final rule.

Despite the aim of providing clarity for ERISA fiduciaries, the Proposal creates confusion. This appears to be, in part, because of a failure to distinguish between ESG integration and economically targeted investing (ETI), or impact investing. ESG integration is the consideration of environmental, social and governance factors that are material to long-term financial performance of assets. Understanding and quantifying these factors is part of prudent risk management, and a strategy to take investment actions aimed at responding to those risks. ETIs, or Impact Investments, are investments that aim to provide financial returns as well as collateral, non-financial benefits. For example, ETIs often advertise job creation or climate impact as goals of the investment.

ESG Integration

The Proposal states that an ERISA fiduciary has fulfilled its obligations if they have “selected investments and/or investment courses of action based solely on pecuniary factors.” It goes on to state that, “ESG factors and other similar factors may be economic considerations.” There is now an extensive body of research that makes clear that ESG factors are material investment considerations. This is the basis for our decision to integrate ESG factors into our investment decisions.

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A policy by the DOL, alone, that clarifies that fiduciaries must integrate material factors into their investment actions and that ESG factors may be material would be appropriate. We are concerned, however, that the remaining components of the proposal create confusion and could cause fiduciaries to believe they are not permitted to consider material ESG factors in their investment analysis.

The “all else being equal test”

Payden & Rygel is concerned that the NPR creates new burdens for fiduciaries using the “all else being equal test” that would lead to unnecessary costs for plan participants. It also creates confusion about what activities the DOL is attempting to regulate.

Under the “all else being equal test,” which has been in place since 1994, fiduciaries may select an investment that provides collateral benefits only after they have determined that the risk and return profile of that investment option is substantially similar to that of competing options that would meet the financial needs of the fund just as well.

The Proposal raises questions about whether fiduciaries would, in reality, ever have the opportunity to select between multiple investment options. It proposes the retention of the “all things being equal” test but adds new recordkeeping requirements for fiduciaries to document their analysis that multiple options were equal and that it was, therefore, appropriate to make a decision based on collateral benefits.

However, as detailed above, ESG factor integration is not decision making based on collateral benefits. It is a core part of fundamental research, and a diligent execution of fiduciary duty.

The Proposal’s discussion of the “all things being equal test” is cause for confusion because, while the test was originally developed to guide the consideration of ETIs, and the discussion in the Proposal appears to envision the selection of an ETI investment, the language of the Proposal does not distinguish the application of this test from the broader discussion of ESG integration.

Defined contribution plan investment options

The Proposal clarifies that ERISA fiduciaries may select “ESG-themed funds” as an investment option for a participant-directed plan but that an “ESG-themed fund” cannot be selected as the default investment option. This determination appears to be informed by confusion between ESG integration and ETIs, or Impact Funds. In our view, all investment options should be required to integrate ESG factors, as part of prudent investment decision-making. In addition, it may be appropriate for ERISA fiduciaries to offer ETIs or Impact Funds as options that participants may select in participant-directed plans.

The Department’s stated rationale for prohibiting an “ESG-themed fund” from being selected as the default investment option is that it is not appropriate to select “investment funds whose objectives include non-pecuniary goals.” This statement shows a fundamental misunderstanding of the purpose of ESG integration, which is to integrate all material factors into investment decision-making. In addition, it is likely to cause confusion for fiduciaries as they attempt to rationalize conflicting statements in the Proposal about the economic materiality of ESG factor consideration.

Conclusion

The Proposal mischaracterizes ESG integration and fails to distinguish between ESG integration and economically targeted investing, or impact investing. This is likely to lead to confusion for ERISA fiduciaries, and additional cost to plan savers. If the Proposal is finalized in its current form, we are concerned that fiduciaries will struggle to fulfil their obligations to integrate all financially material risk factors while also trying to respond to the language in the Proposal that appears aimed at preventing fiduciaries from taking account of these same risks.

As institutional investors, we have a duty to act in the best interests of our clients. In this fiduciary role, we believe ESG factors are among the material factors in fundamental credit and equity analysis and hence integration of such factors is important to the investment decision-making process. If the Proposal goes into effect, it will undermine our ability to act in the long-term best interest of our beneficiaries. As such, we urge you to allow the existing guidance to remain in effect and not move forward with a final rule.

Payden & Rygel Managing Committee

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