

*Via Regulations.gov*

July 30, 2020

Office of Regulations and Interpretations  
Employee Benefits Security Administration  
U.S. Department of Labor  
200 Constitution Avenue, NW  
Washington, DC 20210

Re: DOL Proposal Financial Factors in Selecting Plan Investments, 85 Federal Register 39113 (June 30, 2020)

Dear Ladies and Gentlemen:

The American Bankers Association<sup>1</sup> (ABA) appreciates this opportunity to comment on the Department of Labor's proposal, *Financial Factors in Selecting Plan Investments*, that amends existing regulations governing the investment duties of fiduciaries under the Employee Retirement Income Security Act of 1974 (ERISA). According to the release, the Department seeks to "confirm that ERISA requires plan fiduciaries to select investments and investment course of action based solely on financial considerations relevant to the risk-adjusted economic value of a particular investment or investment course of action."<sup>2</sup>

Our member banks, savings associations, and trust companies (collectively, "banks") have an interest in the proposal both as providers of products and services to third-party ERISA retirement plans, as well as sponsors of plans for their own employees. Although the intent to confirm the duties of plan fiduciaries under ERISA section 404 is understandable, we believe the proposal as written is not only unnecessary, but also potentially inconsistent with the statute and burdensome to affected parties in ways not addressed in the required regulatory impact analysis. We, therefore, urge the Department to withdraw its proposal and engage the industry to seek substantive public input on these matters.

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<sup>1</sup> The American Bankers Association is the voice of the nation's \$20.3 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard \$15.8 trillion in deposits and extend nearly \$11 trillion in loans.

<sup>2</sup> 85 FR 39113.

## Summary of the Proposal

For the first time since first promulgated in 1979, the Department proposes amending 29 CFR 2550.404a-1, *Investment duties*, to add new provisions that more than double its length. While acknowledging that there is no current problem to solve,<sup>3</sup> the Department states that guidance is necessary because of questions the Department has received on the application of fiduciary principles to the selection of investments based on “non-pecuniary benefits they may further, such as those related to environmental, social, and corporate governance considerations.”<sup>4</sup> Under the proposal, the regulation would be amended to:

- Incorporate a reference to the duty of loyalty found in ERISA section 404(a)(1)(A).
- Require that a fiduciary evaluate investments based solely on pecuniary factors that have material effect on the risk and return and not subordinate the interests of the plan participants to “unrelated objectives.”
- Require fiduciaries to compare investments with alternatives based on the consideration of factors in 2550.404a-1 (b)(2)(ii)(A)-(C) (e.g., diversification of the portfolio, liquidity and current return of the portfolio relative to the anticipated cash flow requirements of the plan; and projected return of the portfolio relative to the funding objectives of the plan).
- Impose a rebuttable presumption that “environmental, social, corporate governance, or other similarly oriented considerations” (ESG) are not pecuniary unless “they present economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories.”
- Impose additional requirements on fiduciaries when selecting investments based on ESG factors, including an analysis and documentation that the investment is “economically indistinguishable” from alternatives.
- Impose additional requirements for fiduciaries of defined contribution plans with “investment alternatives that include one or more environmental, social, corporate governance, or similarly oriented assessments or judgements in their investment mandates, or that include these parameters in the fund name.”
- Prohibit the ESG investment mandate alternatives from being “added as, or as a component of, a qualified default alternative (QDIA) subject to 29 CFR 2550.404c-5.

## Proposal Is Potentially Inconsistent with ERISA Section 404(a)(1)

Under ERISA section 404(a)(1), plan fiduciaries must administer a covered plan for the exclusive purpose of providing benefits to participants and their beneficiaries “with the care,

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<sup>3</sup> 85 FR 39120. The preamble states: “The transfer impacts, benefits, and costs associated with the proposed rule depends on the number of plan fiduciaries that are currently not following or misinterpreting the Department’s existing sub-regulatory guidance. While the Department does not have sufficient data to estimate the number of such fiduciaries, the Department believes it is small, because most fiduciaries are operating in compliance with the Department’s sub-regulatory guidance.”

<sup>4</sup> 85 FR 39114.

skill, prudence, and diligence under the circumstances then prevailing that a *prudent man 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.” [Emphasis added] This standard provides flexibility for the fiduciary to exercise its discretion prudently and consider all relevant factors under the circumstances. The existing Investment Duties regulation supports this principled approach to investing by not prescribing any particular investment factor or strategy, other than consideration of diversity, liquidity, and projected return.

Key to meeting this duty as articulated in the statute and existing regulation is having a prudent process in place for investment decisions. Hence, the Department recently stated with respect to investments in private equity: “In evaluating a particular investment alternative for consideration as a designated investment alternative, the fiduciary must engage in an objective, thorough, and analytical process that considers *all relevant facts and circumstances and then act accordingly*.”<sup>5</sup> [Emphasis added] This statement does not limit the relevant facts and circumstances, nor does it presume any particular factor is non-pecuniary or unrelated to material economic considerations. Hence, it would be appropriate for a fiduciary to consider subjective factors when selecting an investment manager, such as skill and reputation of the investment team and any potential regulatory or legal matters.

In an earlier Information Letter, the Department elucidated what may be relevant information for a fiduciary to consider when investing. The letter dealt with the consideration of derivatives investments in a plan. After stating the importance of a prudent process, the letter highlights the consideration of non-financial factors, such as skilled personnel and legal considerations:

In determining whether to invest in a particular derivative, plan fiduciaries are required to engage in the same general procedures and undertake the same type of analysis that they would in making any other investment decision.... In particular, the fiduciary must determine ... whether the plan fiduciary has personnel who are competent to manage these systems. If the investments are made by outside investment managers hired by the plan fiduciary, that fiduciary should consider whether the investment managers have such personnel and controls and whether the plan fiduciary has personnel who are competent to monitor the derivatives activities of the investment managers.

Plan fiduciaries have a duty to evaluate the legal risk related to the investment. This would include assuring proper documentation of the derivative transaction and,

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<sup>5</sup> Information Letter from Louis J. Campagna to Jon W. Breyfogle (June 3, 2020), available at <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/our-activities/resource-center/information-letters/06-03-2020.pdf>.

where the transaction is pursuant to a contract, assuring written documentation of the contract before entering into the contract.<sup>6</sup>

The factors discussed above are not necessarily “financial factors,” but are nonetheless relevant for purposes of section 404(a)(1) and material to the investment’s risk and return and hence are “pecuniary.”

Proposed section (c)(1), *Consideration of Pecuniary vs. Non-Pecuniary Factors*, however, broadly presumes that *all* ESG considerations, even those that may be relevant, are non-pecuniary unless proven otherwise. This rebuttable presumption and additional requirements for comparison with economically indistinguishable alternative investments in (c)(2) are not supported by the more flexible language in the statute. Of particular concern is the vagueness of the terms used in this subsection and potential to expand the scope of the proposed rule in many directions. The terms environmental, social, governance, and “similarly oriented consideration” are themselves potentially broad and could sweep in a host of relevant, pecuniary, material, and prudent factors that are commonly and reasonably considered by “qualified investment professionals” under “generally accepted investment theories.”

Given that the statute provides a more flexible approach for consideration of relevant factors, is there benefit to unnecessarily and potentially imprudently limiting the fiduciary? When the Uniform Prudent Investor Act was adopted, one of the major evolutions from the previous Prudent Man Rule was the elimination of all “categoric restrictions on types of investments” and the clarification “that no particular kind of property or type of investment is inherently imprudent.” The commentary to section 2 further states: “The universe of investment products changes incessantly. Investments that were at one time thought too risky, such as equities, or more recently, futures, are now used in fiduciary portfolios.” We believe these sentiments expressed in 1994 remain true today with respect to ESG investments.

Ultimately, this proposal would affect not only the consideration of economically targeted investments (ETI), but also investment funds that may have an ESG theme or focus, as well as the integration of these factors in investment decisions (ESG integration). With each type of investment or course of action (e.g., ETI, ESG-themed funds, and ESG integration), the proposal unnecessarily limits the fiduciary’s consideration of otherwise prudent investment options.

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<sup>6</sup> Information Letter from Olena Berg to Eugene A. Ludwig (Mar. 21, 1996), available at <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/information-letters/03-21-1996>.

## **Proposal Limits the Prudent Integration of ESG Factors for Risk Mitigation**

The consideration of ESG and similarly oriented factors in investing, often referred to as ESG integration, has been evolving and growing for decades primarily to help manage investment risks and to provide a proxy for management quality, both pecuniary factors.<sup>7</sup> There is significant research that supports the benefits for investors and positive risk adjusted returns.

In a 2018 Government Accountability Office study, the majority of asset managers interviewed found that “incorporating ESG factors enhanced retirement plans’ risk management. For example, an asset manager explained that assessing a company on how it addresses ESG risk factors can give investors a better idea of the quality of the company’s management, thereby enhancing how the investor manages risks. Another asset manager said its clients viewed incorporating ESG factors as a means to help manage the volatility of their portfolios.”<sup>8</sup> The GAO also noted more than half of the asset managers interviewed found “incorporating ESG factors to improve the long-term performance of retirement plan portfolios.” Another more recent study found “that sustainable funds provided returns in line with comparable traditional funds while reducing downside risk. What’s more, during a period of extreme volatility, we saw strong statistical evidence that sustainable funds are more stable. Incorporating environmental, social, and governance (ESG) criteria into investment portfolios may help to limit market risk.”<sup>9</sup>

Instead of providing the needed flexibility to consider all relevant factors, the proposal unnecessarily limits the discretion of the fiduciary to determine that ESG factors may have a “material effect on the return and risk of an investment” by requiring “qualified investment professionals” to treat the factor as material economic considerations under generally accepted investment theories. Fiduciaries need the discretion to evolve with the constantly changing financial landscape and theories that also develop alongside it. It would be unfortunate to lock in a negative presumption against factors that fiduciaries now may deem relevant and prudent, and more may find so in the future.

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<sup>7</sup> CFA Institute Survey, *Global Perceptions of Environmental, Social, and Governance Issues in Investing* (2017) The Survey found that the majority of CFA Institute members (73%) take ESG issues into account in their investment analysis and decisions “to help manage investment risks” (65%), which is a type of pecuniary concern.

<sup>8</sup> GAO Report, *Retirement Plan Investing: Clearer Information on Consideration of Environmental, Social, and Governance Factors Would Be Helpful* (2018).

<sup>9</sup> Morgan Stanley, *Sustainability Reality: Analyzing Risk and Returns of Sustainable Funds* (2019), available at [https://www.morganstanley.com/content/dam/msdotcom/ideas/sustainable-investing-offers-financial-performance-lowered-risk/Sustainable\\_Reality\\_Analyzing\\_Risk\\_and\\_Returns\\_of\\_Sustainable\\_Funds.pdf](https://www.morganstanley.com/content/dam/msdotcom/ideas/sustainable-investing-offers-financial-performance-lowered-risk/Sustainable_Reality_Analyzing_Risk_and_Returns_of_Sustainable_Funds.pdf).

### **Existing QDIA Regulations Are Sufficient For Determining Prudent Plan Investments**

The proposed new subsection (c)(3)(iii) seems to prohibit outright the ability for qualified default investment alternatives (QDIA) to include, even as a component, ESG or similarly oriented investment mandate alternatives. Given the pervasive use of such factors, particularly governance considerations, in investment decisions, such a prohibition would significantly and imprudently limit the available options for these plans. This prohibition would ironically seem to apply even though the ESG investment is otherwise prudent, outperforms other funds that do not consider these relevant factors, and meets the other requirements in the proposal. Moreover, such a prohibition is an unnecessary overlay to existing regulations that have properly governed QDIAs for years in 29 CFR 2550.404c-5, requiring the fiduciary “to prudently select and monitor any qualified default investment alternative under the plan.”

### **DOL Should Not Arbitrarily Dissuade the Use of Relevant Research and Tools**

As noted in footnote 24 of the preamble, the Department states its skepticism of “‘ESG rating systems’ – or any other rating system that seeks to measure, in whole or in part, the potential of an investment to achieve non-pecuniary goals – as a tool to select designated investment alternatives, or investments more generally.” This broad statement presumes that ESG ratings systems are for the furtherance of non-pecuniary goals, which is not necessarily the case. The Department’s presumption also does not seem to allow for fiduciary discretion to consider, through a prudent process, criteria, ratings systems, and other helpful tools that assist in the selection and consideration of ESG factors in investments. Ultimately, we believe the Department should not weigh in on the use and development of benchmarks, criteria, etc. that asset managers employ when making investment decisions, especially as they may evolve and improve with further research and analysis. The selection of these tools should be left to the discretion of the fiduciary after consideration through a prudent investment process.

### **Cost-Benefit Analysis Does Not Address All Likely Burdens on the Retirement Industry**

The proposal as written would impose burdens on the retirement industry in ways that the Department has not addressed fully in the regulatory impact analysis required by Executive Orders 12866 and 13563. These additional compliance costs to plans and financial institutions

and reduced access to prudent investment options could have negative, unintended consequences.

### *Plan Level Fiduciaries*

Plan level fiduciaries (plan sponsors) may incur significant and potentially ongoing costs to conform otherwise prudent investment decisions to meet the proposed rule's new documentation and analysis requirements. For example, plan sponsors that offer or are considering to offer otherwise prudent ESG investment options (e.g., ETIs, ESG-themed funds, or investments using ESG integration) must now rebut the proposal's presumption and affirmatively analyze and document that ESG or other similar factors are pecuniary. This new test may only be met by determining that the ESG factor(s) present "economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories." In addition, the plan sponsor must conduct a new type of analysis to show that the investment option is "economically indistinguishable" from alternative options.

Even if a plan sponsor believes it has not considered ESG factors in meeting its investment duties, it may still feel compelled to conduct a review of existing investment option documents and investment decisions to determine whether it is actually in scope of the rule. Such analysis could easily require several hours of internal or outside legal or other counsel, potentially over a thousand dollars per plan. In both the situations, the compliance burdens placed on plan sponsors are not a one-time affair, but potentially ongoing for each investment decision of the fiduciary.

### *Financial Institutions*

The regulatory impact analysis has no discussion of the effect of this proposal on non-plan level fiduciaries, such as banks acting as trustee of a collective investment trust or manager of a separate account for a plan. The lack of such analysis supports our presumption that this proposed rule in fact would not apply to these types of ERISA fiduciaries. However, to the extent our presumption does not align with the Department's position, we would note that the same costs to plan level fiduciaries noted above would also apply to non-plan level fiduciaries, such as banks, multiplied by the number of investment decisions made in the normal course of managing a plan asset vehicle.

In particular, the requirements in proposed subsections (b)(2)(ii)(D) and (c) to compare the investment or investment course of action with available alternative investments or investment courses of action would not only be costly to administer, but practically difficult to implement. Funds that invest in real property illustrate the difficulty in complying with the proposal as written. Real property, by its nature, is unique, where no two investments are exactly alike. When considering a real property investment, the investment manager may have no other opportunity or property for sale in the given market that could serve as a basis for comparison. Moreover, what would appear to be similar properties in other markets may be all the less comparable.

For these reasons, a real estate manager will typically determine whether the property meets certain threshold criteria, such as with regard to potential risk and expected return, and if it does so, evaluate it based on a number of factors, such as an environmental site assessment report. The investment decision is often made looking at all these factors in the aggregate in light of what is prudent for, and accretive to, the overall portfolio. The decision does not necessarily rest on whether particular factors taken into account as relevant to the overall economics of the decision would be considered ESG, “pecuniary ESG,” or otherwise under the described standards, or whether they would be “material” economic considerations versus “non-material” considerations.

As such, it would be difficult, if not impossible, to determine, and document accordingly, whether an investment decision being based in part on what could be regarded as environmental and social factors is “economically indistinguishable” from other real property investments that might be available at a given time. This difficulty is especially present when comparable properties are not in the same market or are not within the investment guidelines for the real estate manager. In the end, it would be difficult for the manager to evaluate prudently the investment *without* taking ESG factors, such as an environmental assessment, into account.

#### *Plan Participants and Beneficiaries*

Lastly, many participants are demanding access to ESG investment options in their plans, as interest grows in this area. According to the 2018 GAO study, over half of the asset managers interviewed stated that incorporating ESG factors into retirement plan investment options would help meet participant expectations and increase participation, especially of younger investors. Indeed, ABA has heard anecdotally from our member banks that their own employees are asking

for more diverse investment options with consideration of ESG factors. In trying to meet the additional proposed fiduciary duties, many of these plan sponsors may be dissuaded from considering otherwise prudent investment options that would encourage employee participation in the plan. These implicit costs to plans, participants, and beneficiaries have not been considered in the regulatory impact analysis.

### **Conclusion**

ABA appreciates this opportunity to comment on the Department's proposal to amend the investment duties regulation. We respectfully urge the Department to withdraw the proposal and engage plan sponsors, financial institutions, and the retirement industry to discuss these issues. We believe, as written, the proposal is unnecessary, potentially inconsistent with the broader statutory prudence requirements, and incomplete in its consideration of the burdens on affected parties. We would welcome an opportunity to discuss these points with the Department.

Sincerely,

*Phoebe A. Papageorgiou*

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Vice President, Trust Policy