

July 30, 2020

Office of Regulations and Interpretations  
US Department of Labor  
Room N-5655  
200 Constitution Avenue NW  
Washington, DC 20210

**RE: Proposed rule on Financial Factors in Selecting Plan Investments (RIN 1210-AB95)**

To whom it may concern:

We write this comment letter to raise red flags that the above proposed rule (the “Proposal”) would unnecessarily reduce the retirement security of millions of American workers and increase economic risks. We have over 60 years of combined experience working with institutional investor fiduciaries, and our comments are informed by that expertise.

We recognize that pension investment fiduciaries have a unique role in risk management because of the fiduciary duties they owe to fund beneficiaries in regard to long-term liability obligations and, as broadly invested universal owners, pension funds are highly susceptible to the economic damage caused by systemic risks. The Dot Com Crash, Great Recession and Coronavirus Crisis illustrate the damage that systemic risk and misinformed policy can wreak on the retirement security of American workers. We think the Proposal is a dangerous proposition which needlessly invites serious economic damage.

**The Proposal Misapplies ERISA Fiduciary Duties to Achieve an Improper Purpose**

We fear that the Proposal would undermine the very ERISA fiduciary standards it cites in order to further what appears to us to be an unrelated political purpose (use of retirement assets to support the fossil fuel and nuclear energy industries) at the expense of retirement savers. By subordinating the financial interests of pension plan participants and beneficiaries to financial needs of the American energy sector, it would set a precedent endorsing politicization of pension investments. The end result would likely be impairment of retirement security for many ERISA plan participants, with corresponding damage to the overall economy.<sup>1</sup>

There are circumstances surrounding impetus for the Proposal that raise questions about its intent. We note several recent developments that illustrate the basis for these suspicions.

- On March 28, 2017, the President issued an Executive Order on Promoting Energy Independence and Economic Growth, which directed that “it is the policy of the United

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<sup>1</sup> Morningstar research demonstrates the consistent outperformance of ESG integration strategies. “Focusing on the trailing annualized three-year returns through the end of 2019, we see a similar pattern. The returns of 40% of sustainable funds placed in the top quartile of their categories, and two thirds finished in the top half.” <https://www.morningstar.com/articles/973590/us-esg-funds-outperformed-conventional-funds-in-2019>  
We are aware that numerous other comment letters received on the Proposal by the Department contain detailed current data on the outperformance of integrated ESG investing. Rather than fill this comment letter with duplicative references, we also refer the Department to those submissions.

States that executive departments and agencies (agencies) immediately review existing regulations that potentially burden the development or use of domestically produced energy resources and appropriately suspend, revise, or rescind those that unduly burden the development of domestic energy resources beyond the degree necessary to protect the public interest or otherwise comply with the law. . . . The heads of agencies shall review all existing regulations, orders, guidance documents, policies, and any other similar agency actions (collectively, agency actions) that potentially burden the development or use of domestically produced energy resources, **with particular attention to oil, natural gas, coal, and nuclear energy resources.**"<sup>2</sup> (Emphasis added.)

- Eugene Scalia took over as Secretary of the Department of Labor in December 2019 after representing the U.S. Chamber of Commerce and the Securities Industry and Financial Markets Association, while at the law firm Gibson Dunn, in successfully challenging expansion of fiduciary duties to protect retail investors.<sup>3</sup> At the Department of Labor he sought, and obtained, approval from ethics counsel to participate in fiduciary duty rulemaking, despite apparent conflicts from his prior advocacy role.<sup>4</sup>
- After Scalia took office as Secretary of Labor, the Department issued the Proposal based on an obviously flawed analysis of outdated research on socially responsible investment practices that are unrelated to integration of material ESG factors into investment analysis, which has grown by more than 15 percent per year since 2016 and been adopted by investors with \$40 trillion under management.<sup>5</sup> Furthermore, the Proposal completely disregards recent statements by mainstream investor fiduciaries that consideration of ESG factors has been found to improve returns and reduce risks.<sup>6</sup> These ESG considerations are clearly pecuniary, though the Proposal arbitrarily concludes they are not.<sup>7</sup>

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<sup>2</sup> <https://www.whitehouse.gov/presidential-actions/presidential-executive-order-promoting-energy-independence-economic-growth/>

<sup>3</sup> <https://www.pionline.com/washington/labor-secretary-scalia-gets-green-light-participate-fiduciary-standard-rule-making>

<sup>4</sup> Id

<sup>5</sup> <https://www.marketsmedia.com/esg-assets-have-grown-15-annually/>

<sup>6</sup> For example, Blackrock issued a report earlier this year stating, "In the first quarter of 2020, we have observed better risk-adjusted performance across sustainable products globally, with 94% of a globally-representative selection of widely-analyzed sustainable indices outperforming their parent benchmarks. While this short time period is not determinative, it aligns with the resilience we have seen in sustainable strategies during prior downturns, explored below in section "Sustainability Performance in the Markets." Furthermore, these results are consistent with the research BlackRock has been publishing since mid-2018," <https://www.blackrock.com/corporate/literature/investor-education/sustainable-investing-resilience.pdf>

<sup>7</sup> The Proposal says, "ESG investing raises heightened concerns under ERISA." However, Blackrock reports that, "In the first quarter of 2020, Morningstar reported 51 out of 57 of their sustainable indices outperformed their broad market counterparts, and MSCI reported 15 of 17 of their sustainable indices outperformed broad market counterparts - robust across region and index methodology. While this short time period is not determinative, it aligns with the resilience we have seen in sustainable strategies during prior downturns in 2015-2016 and 2018, which are explored in our research. Furthermore, these results are consistent with the research BlackRock has been publishing since mid-2018, demonstrating that sustainable strategies do not require a return tradeoff and have important resilient properties." <https://www.blackrock.com/corporate/literature/investor-education/sustainable-investing-resilience.pdf>

- Finally, the Proposal’s official docket on regulations.gov explicitly identifies it as having “Impacts and Effects” on “Energy” and lists its “Priority” as “Economically Significant.”<sup>8</sup> This is hard to square with the Proposal’s official cost analysis conclusion that “incremental costs of the proposed rule are estimated to be minimal.” It also begs the question, “Why are the Proposal’s main impacts and effects listed as being on “energy” as opposed to workers or pension plans?”

The Proposal says that pension plans covered by ERISA are statutorily bound to “management with an ‘eye single’ to maximizing the funds available to pay retirement benefits” and “plan assets may not be enlisted in pursuit of other social or environmental objectives.” However, it appears to completely disregard that mandate by doing exactly what is prohibited - proposing to prohibit use of generally accepted investment practices in order to divert ERISA pension fund assets for use in implementation of an Executive Order requiring that Federal agencies promote development or use of domestically produced energy resources, with particular attention to oil, natural gas, coal, and nuclear energy resources. Given the increasing movement of institutional investor assets away from carbon based industries, the focus on discrediting ESG integration seems logical. Nevertheless, it is also a violation of the ERISA fiduciary duty standards cited above.

In *Little Sisters of the Poor and Paul Home v. Pennsylvania* 2020 WL 3808424, the U.S. Supreme Court addressed a similarly deficient regulatory proposal. The Court said, “Our precedents require final rules to “articulate a satisfactory explanation for [the] action including a rational connection between the facts found and the choice made.” This requirement allows courts to assess whether the agency has promulgated an arbitrary and capricious rule by “entirely fail[ing] to consider an important aspect of the problem [or] offer[ing] an explanation for its decision that runs counter to the evidence before [it].” We see the Proposal as subject to the same fate.

### **The Proposal Breaches Trust Law Principles Incorporated into ERISA**

This arbitrary endorsement of outdated investment practices, while excluding recently improved and generally accepted investment theories that have been found to improve investment results and been adopted by a large (and growing) segment of mainstream investment firms with \$40 trillion under management,<sup>9</sup> the Proposal runs counter to established trust law principles. When Congress created ERISA, it chose to “apply rules and remedies similar to those under traditional trust law to govern the conduct of fiduciaries.”<sup>10</sup>

The *Restatement of Trusts*, the leading authority on trust law, was amended in 1992 in response to decades of debate over the transition to investment industry adoption of Modern Portfolio Theory. The *Restatement of Trusts (Third)* summarizes the trust law principle that informed resolution of that debate. “Trust investment law should reflect and accommodate current knowledge and concepts. It should also avoid repeating the mistake of freezing its rules against future learning and developments.”<sup>11</sup>

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<sup>8</sup> <https://www.regulations.gov/docket?D=EBSA-2020-0004>

<sup>9</sup> *ESG Data Integration by Asset Managers: Targeting Alpha, Fiduciary Duty & Portfolio Risk Analysis* (June 2020), Opimas; <http://www.opimas.com/research/570/detail/> (visited July 21, 2020).

<sup>10</sup>Conference Report on HR 2, Pension Reform, HR Rep. No. 93-1280, 93d Cong., 2d Sess. 295, reprinted in 3 Legislative History of the Employee Retirement Income Security Act of 1974, 94th Cong., 2d Sess. 4277, 4562 (1976).

<sup>11</sup>RESTATEMENT (THIRD) OF TRUSTS ch. 17, intro. note (AM. LAW INST. 1992).

The Proposal violates this fundamental trust law principle by failing to recognize that fiduciary duty is a dynamic concept. It ignores current knowledge and accepted investment concepts while seeking to freeze interpretation of fiduciary duties against recent learning. In doing so, the Proposal goes beyond what Congress envisioned when enacting ERISA.

### **Inconsistencies in the Proposal will Increase Confusion**

The Proposal acknowledges that ESG can be financially material but then goes on to apply unique and costly extra documentation and due diligence requirements based on the assumption that ESG is not actually a material investment consideration and is likely to decrease returns. It says that ESG can be considered when it relates to pecuniary considerations and presents an economic opportunity or risk that would be treated as material economic considerations under generally accepted investment theories. However, the Proposal then ignores current data and statements from mainstream institutional investors that material ESG issues are being integrated into their due diligence processes because they have found it adds returns and reduces risks. These non sequitur statements seem intended to confuse rather than clarify. The use of ambiguous terms, like “appropriately” and “qualified investment professionals” add uncertainty that places fiduciaries in a situation where they cannot predict what might be seen as the basis for an enforcement action.

Furthermore, the Proposal fails to define ESG and lumps it together with Impact Investing, Values Based Investing and other social investing strategies that are completely different from integration of material ESG factors into investment analysis. This confusing mashup paints fundamentally different investment approaches with a broad brush.<sup>12</sup>

In addition, the rule uses an intellectual bias that applies different standards to favored and disfavored investment strategies. In doing so, the DOL creates “slippery slope” concerns about the ability of regulators to impose, and fiduciaries to know predict, whether ESG-type special documentation is also required for other accepted investment practices that have a checkered performance record. For example:

- Active managers underperform their benchmarks far more regularly than ESG managers.<sup>13</sup> Do decisions to use active managers now require greater documentation?
- Over the past five years, the Dow Jones US Oil and Gas Index substantially underperformed the S&P 500 ESG Index.<sup>14</sup> Does that mean that ERISA fiduciaries cannot invest in oil and gas stocks because they underperform ESG funds, which the Proposal says “raises heightened concerns under ERISA”?

This Proposal will create confusion that is likely to result in fiduciaries making investment decisions based on fear of becoming subject to an enforcement action or investigation, rather than applying current knowledge and data to identify investment approaches which serve the financial

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<sup>12</sup> Blackrock describes the differences between ESG integration and other investment approaches at <https://www.blackrock.com/ch/individual/en/themes/sustainable-investing/esg-integration>.

<sup>13</sup> According to Morningstar, only 40% of active funds beat their indexes last year, which was an improvement from 2018. <https://www.morningstar.com/articles/962251/article>

<sup>14</sup> As of the date of this submission, the Oil and Gas Index lost more than 12 percent over the past five years, while the S&P 500 ESG Index delivered a 9.5 percent positive return.

interests of ERISA plan participants. American workers will bear the costs and be the ultimate holders of added risks created by the Proposal. We respectfully request that the Proposal be withdrawn.

Thank you for your consideration of these comments.

Sincerely,

Sarah Cleveland  
Independent Consultant  
Former Sr. Consultant, Towers Watson Investment Services, Inc.

Stephen Viederman  
Former Executive Director, Jessie Smith Noyes Foundation  
Former President, Network for Sustainable Financial Markets