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Office of Regulations and Interpretations  
Employee Benefits and Security Administration  
United States Department of Labor  
200 Constitution Avenue NW  
Washington, DC 20210

**Re: Financial Factors in Selecting Plan Investments (RIN 1210-AB95)**

We are submitting this comment letter on behalf of the Coalition of Collective Investment Trusts (the "Coalition"),<sup>1</sup> in response to the proposal (the "Proposal") issued by the U.S. Department of Labor (the "Department") soliciting comments on proposed amendments to the Department's regulations describing the investment duties of fiduciaries under the Employee Retirement Income Security Act of 1974, as amended ("ERISA").<sup>2</sup> The Coalition is a group of fund sponsors and money managers active in the collective investment trust ("CIT") industry. With approximately 45 member companies, the Coalition collectively represents a sizeable presence in the industry. This letter represents the general views of the Coalition but not necessarily those of individual member companies.

The Coalition appreciates the opportunity to submit these comments on the Proposal to the Department.

**BACKGROUND**

The Proposal would amend the Investment Duties safe harbor regulation (the "Investment Duties Regulation") adopted in 1979 to endorse modern portfolio theory. The Investment Duties Regulation was intended as a safe harbor so that "fiduciaries who comply with the provisions of the regulation will have satisfied the requirements of the "prudence" rule...."<sup>3</sup> It was not intended to be a prohibitive rule, nor was it intended to set forth requirements that would

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<sup>1</sup> The Coalition is comprised of a diverse group of fund sponsors, money managers and service providers. Additional information is accessible via: <https://www.ctfcoalition.com>.

<sup>2</sup> 29 C.F.R. § 2550-404a-1.

<sup>3</sup> 44 Fed. Reg. 37221, 37222 (June 26, 1979).

supersede particular investment decisions made by fiduciaries. The Department has not identified the need for a change, but it is clear that the Department is concerned about particular investments that could be viewed as implicating “environmental, social, corporate governance, or other similarly oriented considerations” (“ESG”).<sup>4</sup>

The proper role of ESG investing in ERISA plans has been the subject of debate since the early 1980s. This debate both mirrors and channels the ongoing debate in broader investment, corporate governance and political circles about shareholder activism and ESG investing generally. The Department’s viewpoint on this debate previously has played out entirely in sub-regulatory guidance, where guidance at times has focused on traditional investment factors being paramount for ERISA fiduciaries, with ESG factors proper only as tie-breakers, and at other times has suggested there may be more latitude for fiduciaries to take account of ESG factors at the margin. While the proper emphasis may have changed from time-to-time, no specific prohibitions or procedures were imposed with respect to ESG investments. We infer from the relative absence of ERISA enforcement cases or private litigation over ESG investments that the Department’s approach to date has been successful and that plan participants have not been disserved as ESG moved into the investment mainstream.

The Coalition agrees with the Department that “ERISA fiduciaries must always put first the economic interests of the plan in providing retirement benefits” and that a “fiduciary’s evaluation of the economics of an investment should be focused on financial factors that have a material effect on the return and risk of an investment based on appropriate investment horizons consistent with the plan’s articulated funding and investment objectives.”<sup>5</sup> A plan’s investment fiduciaries have always been charged with evaluating investments in accordance with a prudent expert standard and this focus is exactly that of a prudent expert. The Coalition’s members are on the forefront of evolving investment dynamics and products, and recognize that a principles-based construct is the most effective method to ensure that fiduciaries are truly able to act in the best interests of the plan and its participants when making investment decisions. The Coalition is concerned that the Proposal effectively replaces the best judgment of a prudent expert, both substantively and procedurally, with “legal list” rules that must be followed whether prudent or not.

## PROPOSED AMENDMENTS

As a formal matter, the Proposal would incorporate three new requirements into the existing Investment Duties Regulation that would obligate the fiduciary:

- To evaluate “investments and investment courses of action based *solely* on “pecuniary factors” (an undefined term) that have a material effect on the return and risk of an investment based on appropriate investment horizons and the plan’s articulated funding and investment objectives” as consistent with ERISA;
- Not to “[subordinate] the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to unrelated objectives, or [sacrifice] investment return or [take] on additional investment risk to promote goals unrelated to those financial interests of the plan’s participants and beneficiaries or the purposes of the plan”; and
- Not to “otherwise [act] to subordinate the interests of the participants and beneficiaries to the fiduciary’s or another’s interests and has otherwise complied with the duty of loyalty.”

The Proposal goes on to provide that ESG factors are pecuniary factors only if “they present economic risks or opportunities that qualified investment professionals would treat as material

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<sup>4</sup> 85 Fed. Reg. 39113, 39114 (June 30, 2020).

<sup>5</sup> 85 Fed. Reg. 39113, 39115 (June 30, 2020).

economic considerations under generally accepted investment theories ...," which fiduciaries must then weigh against other alternative investments. If the available investments are "economically indistinguishable" on this basis (which DOL expects would be a rare occurrence), only then may a non-pecuniary ESG or other factor may be used as the decisive criterion, and even then, the fiduciary must document the decision to "specify why the investments were determined to be economically indistinguishable and ... why the selected investment was chosen based on the purposes of the plan, diversification of investments, and the interests of plan participants and beneficiaries in receiving benefits from the plan."

The Proposal also adds specific criteria for the selection of investment options for defined contribution plans, allowing the investment menu to include options with an ESG mandate or name only provided that:

- The fiduciary use only "objective risk-return criteria" in selecting and monitoring the investment options, and documents that process; and
- Any Qualified Default Investment Alternative ("QDIA") cannot include any ESG component.

### COALITION COMMENTS

The Coalition agrees with the well-accepted principles behind the Investment Duties Regulation, which the Proposal draws upon. The Coalition is concerned, however, with the specificity of the Proposal, which interferes with a fiduciary's best judgment and could have unintended consequences that actually impair a fiduciary's ability to satisfy its fiduciary responsibilities.

In that regard, the Coalition agrees with and references the points raised in several other comment letters being submitted by other industry and trade organizations.<sup>6</sup> Those letters explain in further detail problems with the new provisions, including but not limited to analyses regarding the economic impact of the Proposal. In this letter, the Coalition echoes their concerns and supplements by focusing on the following high level points:

- Because the current version of the Investment Duties Regulation represents a principles-based approach there is no need for amendment, but the Proposal's prescriptive approach in any event is unworkable and will lead to higher costs and other unintended consequences;
- This is particularly illustrative in the case of the new QDIA restrictions, which conflict with the QDIA regulations themselves and do not take into account the potential harm to participants with a long-term investment horizon; and
- If the Department nevertheless determines to finalize prescriptive investment regulations, transition rules and a delayed effective date are essential so that fiduciaries can make necessary changes to investment menus over time while avoiding widespread investment losses to participants.

These points are discussed below in greater detail.

#### A. The Proposal is unduly prescriptive.

The Coalition's strong view is that the best approach to guiding fiduciaries with respect to their investment duties is through the current principles-based approach. While the Coalition respects and understands many of the Department's concerns, as expressed in the preamble, it does not believe that the solution can be found in prescriptive regulations. A principles-based approach

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<sup>6</sup> See, July 30, 2020 comment letter submitted by the U.S. Chamber of Commerce; July 30, 2020 comment letter submitted by the American Bankers Association; and the July 30, 2020 comment letter submitted by the Insured Retirement Institute.

permits its standards to apply in an ever-changing investment marketplace as it evolves over time.

It is rare for the Department to consider singling out particular investments for special scrutiny.<sup>7</sup> In fact, the Department generally disfavors such undertakings. For example, the Department opposed proposed legislation in 2007 that would have required all defined contribution plans to include an index fund as an investment option. The Department opposed that legislation on the basis that specific investment mandates at law “[limit] the ability of employers and workers together to design plans that best serve their mutual needs.”<sup>8</sup>

We also contrast the Proposal with the Department’s recent Information Letter (June 3, 2020) on the use of professionally managed funds with a private equity allocation as designated investment options.<sup>9</sup> The Department did not take a prescriptive approach with what it acknowledged to be complex and risky investments. It did not set up special hurdles to those investments in light of their atypical cost and liquidity considerations. Instead, in an admirable summary of sound fiduciary practice, the Department outlined the incremental considerations fiduciaries should take into account in their facts-and-circumstances diligence of any such investments.

Our point is that the Department has historically recognized that ERISA works best when the Department trusts the principles-based statutory process to guide plan fiduciaries, and we agree. This is true even with regard to the Department’s stated perception that, while ESG has become a mainstream investment category, at this time its parameters and metrics have not been definitively defined, and there may be some “ESG” marketed products that include untested concepts:

- None of those concerns would escape the notice of the diligent fiduciary utilizing the process the Department outlined in the June 3 Information Letter; and
- The market will continue to evolve to address all those concerns and more, and a prudent fiduciary process will take into account such changes as they occur.

The Coalition also questions the premise behind some of the Department’s concerns. For example, the Department expresses concern about an “extra cost” to ESG funds, citing a study that compared actively-managed ESG funds with passive investment options.<sup>10</sup> This is not an issue that is unique to ESG. It is well accepted that actively-managed investment options are typically more costly to manage than their passive counterparts.

We take no exception to ESG guidance from the Department that nets out to a specific application of the ERISA principles-based fiduciary process, i.e., that asks plan fiduciaries to undertake a diligent evaluation process focused only on the interests of plan participants and beneficiaries and to make appropriate decisions based on that process. We understood the Department’s prior guidance to do just that. The Proposal, in perception if not in substance, goes farther and is prescriptive in a manner that will skew the judgments of plan fiduciaries derived from the statutory principles-based process. The Department should not undertake to

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<sup>7</sup> In 2015 and again in 2020, in connection with its investment advice fiduciary project, the Department suggested special treatment for “complex” or “risky” investments. Those suggestions were not incorporated into effective final regulations.

<sup>8</sup> DOL Testimony to the Committee on Ways and Means, U.S. House of Representatives (Oct. 20, 2007).

<sup>9</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-ebesa/our-activities/resource-center/information-letters/06-03-2020.pdf>.

<sup>10</sup> 85 Fed. Reg. 39113, 39116 (June 30, 2020).

substitute its judgment for the judgment of plan fiduciaries as the market evolves over time – the approach Congress specified in the statute.<sup>11</sup>

B. The meaning and scope of the new requirements are unclear.

Our concerns with the Proposal's movement away from principles-based standards are compounded by the uncertainty of the meaning and scope of its provisions. Consider first the specific rules regarding ESG investments. "ESG" itself is not defined and there is at this time no generally accepted definition in the market. As recognized by the Department and stated in the preamble:

"[t]here is no consensus about what constitutes a genuine ESG investment, and ESG rating systems are often vague and inconsistent, despite featuring prominently in marketing efforts."<sup>12</sup>

That is, the Department has not provided reliable guidance on when it deems its Proposal to be applicable. Even if an attempt is made to do so, what is or is not an ESG investment may be a moving target. Moreover, standards and companies evolve, and an investment may fluctuate between ESG and non-ESG. The result in any event will be additional (and unnecessary) costs incurred by plans and service providers for the constant monitoring that will be necessary to determine, for instance, that the underlying investments of pooled funds do not include any investment that could be deemed as an ESG investment.<sup>13</sup>

This uncertainty leads to an even larger dilemma that makes the Proposal unworkable. As recognized by the Department, there are many cases where ESG factors can be pecuniary factors. As a result, two plan fiduciaries or asset managers could make **the same** investment decision based on **the same** underlying factors. One fiduciary could be liable for breach of fiduciary duty based on a perceived intent to promote ESG factors, while the second fiduciary, making the exact same decision would be fine because it viewed these same factors as pecuniary in nature. This anomaly cannot be the right result.

Another significant problem arises with the proposed addition of a new provision<sup>14</sup> that would require a fiduciary to compare each investment or investment course of action to "available alternative investments or investment course of action." This new dictate is confusing and raises more questions than answers:

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<sup>11</sup> In Advisory Opinion 2006-08A, regarding the question of whether funding considerations may be taken into account in selecting investments for a defined benefit plan, the Department summarized the statutory framework as follows:

***Within the framework of ERISA's prudence, exclusive purpose and diversification requirements, the Department believes that plan fiduciaries have broad discretion in defining investment strategies appropriate to their plans.*** In this regard, the Department does not believe that there is anything in the statute or the regulations that would limit a plan fiduciary's ability to take into account the risks associated with benefit liabilities or how those risks relate to the portfolio management in designing an investment strategy. For these reasons, a fiduciary would not, in the view of the Department, violate their duties under sections 403 and 404 solely because the fiduciary implements an investment strategy for a plan that takes into account the liability obligations of the plan and the risks associated with such liabilities and results in reduced volatility in the plan's funding requirements. ***Whether any particular investment strategy is prudent with respect to a particular plan will depend on all the facts and circumstances involved.***

(emphasis added.)

<sup>12</sup> 85 Fed. Reg. 39113, 39115 (June 30, 2020).

<sup>13</sup> These costs have not been fully vetted in the Regulatory Impact Analysis.

<sup>14</sup> Proposed 29 C.F.R. §2550-404a-1(b)(1)(iii)(D).

- Scope: Must a fiduciary conduct this comparison with regard to every investment decision or only as part of its documentation to justify its use of an investment that might be considered to have a non-pecuniary factor? If the scope is broader than just ESG, what are the specific problems identified by the Department that require it to dictate a specific process?
- Standards: It is standard course for fiduciaries to select/monitor investments through comparisons to benchmarks and utilization of other standard tools; what more, if anything, would be required here? What evidence does the Department have that long accepted methodologies should be replaced by this specific process?
- Meaning: What is an “available alternative investment or investment course of action” and how many alternative investments/courses of action must be compared? For example, must a fiduciary compare a mutual fund to every other mutual fund of the same class, and if so, is this costly process intended to replace benchmarking (where an investment professional has already completed a similar process)?<sup>15</sup>

A broad answer to these questions would add tremendous costs with little demonstrated need or benefit, while a narrow reading would further single out investments that are at “risk” of an ESG characterization to special treatment and costs. In any event, while this comparison involves a specific mandate, it is also open-ended, which will inevitably result in a flurry of meritless litigation over the number and scope of these comparisons. We suggest that these comparison provisions are unnecessary given that there are already a variety of prudent processes involved in investment management and that the plan fiduciary is in the best position to determine the appropriate prudent procedure, which may vary between plans. It should be deleted from the Proposal.

The meaning of the following additional terms are similarly problematic:

- The requirement that investments be “economically indistinguishable”, before a plan fiduciary can consider non-pecuniary factors, including ESG factors, is problematic. The Department recognizes in the preamble that “seldom, however, will an ERISA fiduciary consider two investment funds, looking only at objective measures, and find the same target risk return profile or benchmark, the same fee structure, the same performance history, same investment strategy, but a different underlying asset composition. Even then, moreover, those two alternatives would remain two different investments that may function differently in the overall context of the fund portfolio, and which going forward may perform differently based on external economic trends and developments.”<sup>16</sup> The Department is effectively subverting a fiduciary’s best judgment in favor of a standard that it admits will be to be virtually impossible to meet.
- The reference to “generally accepted investment theory” is confusing in this context. In other contexts, we have understood similar references to essentially mean investment considerations within the range of considerations a prudent expert meeting its ERISA section 404(a) duties would take into account, and primarily to exclude “fringe” or outlier theories. As the Department itself describes, however, ESG investment theories are still in the process of coalescing, and it is unclear whether the Department means to say that no ESG investment theory is currently a “generally accepted investment theory.” Further, the Proposal does not provide criteria for a “qualified investment professional”, leading to additional uncertainty as to who a fiduciary can rely upon for that opinion. As is the case with private equity, ESG investments may have a longer time horizon than other investments in the same asset category, but as recognized in the Information Letter, there is a place for such investments in a well-managed plan. The

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<sup>15</sup> Again, the costs of this exercise have not been addressed or justified in the Regulatory Impact Analysis.

<sup>16</sup> 85 Fed. Reg. 39113, 39117 (June 30, 2020). (Emphasis added.)

- principles based analysis in the Information Letter are equally applicable to ESG considerations in the investment process. No further regulation is required.
- Similarly, the Department has not provided any reliable way to judge when ESG considerations cease being economic, and cross the line between pecuniary and non-pecuniary benefits.
- C. The QDIA restriction is inconsistent with the QDIA regulations and will add unnecessary costs for plans.

This provision is not related to the purpose of the QDIA regulations and contradicts its structure. When released, the Department explained that the QDIA “final regulation does not identify specific investment products – rather, it describes mechanisms for investing participant contributions. The intent is to ensure that an investment qualifying as a QDIA is appropriate as a single investment capable of meeting a worker’s long-term retirement savings needs.”<sup>17</sup>

Moreover, the QDIA regulations make clear that “selection of a particular qualified default investment alternative ... is a fiduciary act and, therefore, ERISA obligates fiduciaries to act prudently and solely in the interest of the plan’s participants and beneficiaries.” Again, it is not necessary to single out ESG investments because fiduciaries cannot rely on the QDIA regulation to protect them from imprudent selection of a QDIA.

As intended by the Department, many plans have chosen professionally managed funds, including target date funds, as the QDIA for their plans. In such cases, the Department’s concerns about plan-level fiduciaries putting their own non-pecuniary interests above the pecuniary worth of the investment is simply unwarranted, as they are relying on the fund managers to choose the individual components of the investment strategy. These funds may in fact include an ESG allocation, on the basis that it does not correlate with broad market movements and provides diversification for the balance of the portfolio. The absolute prohibition proposed by the Department would add unnecessary costs and burdens on plan fiduciaries, who would have to constantly monitor every investment decision within the managed fund to ensure that it agrees that no “ESG” type investments have been included.

- D. Transition rules are necessary to avoid economic harms.

The Coalition strongly recommends that if the Proposal is finalized, it incorporates transition rules, including grandfathering of existing plan investments. This is absolutely necessary not only because fiduciaries will be unable to comply retrospectively with prescriptive requirements, but also to avoid the wide-ranging economic harms that could follow a sudden investment mandate,

- Given current market conditions, plans might be compelled to sell existing assets in a down market, to the detriment of participants and beneficiaries, and could even disrupt markets to the detriment of the overall US economy. Markets are not structurally able to handle prolonged extended trading, liquidity will suffer, and since global markets are interconnected, the negative effects will be exported globally;
- Participants will incur transition costs by forced exiting strategies or as a result of managers having to offload/buy certain securities to meet the new requirements (e.g. commissions, taxes, stamp duty, etc.);

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<sup>17</sup> See “DOL Fact Sheet, Regulation Relating to Qualified Default Investment Alternatives in Participant-Directed Individual Account Plans”, April 2008 available at <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebbsa/our-activities/resource-center/fact-sheets/final-rule-qdia-in-participant-directed-account-plans.pdf>

- The sudden and widespread trading needs may raise challenges meeting best execution obligations;
- Participants will incur forced realization of unrealized losses.

**CONCLUSION**

Once again, the Coalition appreciates the opportunity to provide these comments to the Proposal. Our view is that the current regulation works well as a principles-based standard, while the prescriptive approach of the Proposal would inappropriately impair the ability of fiduciaries to fulfill their statutory duties and ultimately harm plan participants. We strongly encourage the Department to withdraw the Proposal as written or alternatively to release a substantially revised proposal that retains the principles-based approach consistent with the current regulation.

Respectfully submitted,

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