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Submitted Electronically Through www.regulations.gov

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Ave NW
Washington, DC 20210

RE: Notice of Proposed Rulemaking on Financial Factors in Selecting Plan Investments Amending “Investment duties” Regulation at 29 CFR § 2550.404a-1 (RIN 1210-AB95)

Dear Acting Assistant Secretary Klinefelter Wilson:

On behalf of a group of our clients that provide investment management, insurance, distribution, and investor relations services (the “Group”), we are requesting that the Department of Labor (the “Department”) extend the comment period for an additional 60-days and hold public hearings on the Department’s proposed regulation titled “Financial Factors in Selecting Plan Investments” and published in the Federal Register on June 30, 2020 (the Proposed Rule” or “Proposed Regulation”).¹ In addition to our request, we are submitting comments to the Proposed Rule. However, with additional time, we believe that the Department would benefit from meaningful public participation in the rulemaking process. Unfortunately, we do not believe that such participation is currently possible under the existing 30-day comment period given the overwhelming challenges posed by the pandemic, civil unrest, and economic crisis facing our nation.

Nonetheless, we appreciate the Department’s efforts to engage in notice and comment with respect to the Proposed Rule implementing the existing fiduciary duties of Prudence² and Loyalty³ under the Employee Retirement Income Security Act of 1974, as amended (“ERISA”).

¹ Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 39113 (proposed June 30, 2020).

² Employee Retirement Income Security Act of 1974 § 404(a)(1)(B) (the “Duty of Prudence”).

³ Employee Retirement Income Security Act of 1974 § 404(a)(1)(A) (the “Duty of Loyalty”).

Despite our concerns regarding the timing and content of the Proposed Rule, it is evident that the Department has worked exceptionally hard in its preparation, and we admire both the Department's impressive industry and sincere desire to provide employee benefit plan participants and beneficiaries with clear protections regarding the investment of plan assets supporting their benefits. Hopeful that the Department will grant an extension, we would like to continue to work constructively with Secretary Scalia, you, and your staff to improve and refine the Proposed Rule going forward.

I. Request to Extend the Comment Period for the Proposed Rule to September 28, 2020 and Hold Public Hearings

We believe that the current 30-day period for public comment is insufficient given the scope of the proposed rulemaking, coinciding public comment periods for other Employee Benefits Security Administration ("EBSA") projects, and the ongoing public health emergency resulting from the Coronavirus Disease ("COVID-19"). The current comment period comprises only 21 business days, and EBSA published the proposed regulation in the Federal Register just two days before the Fourth of July holiday weekend. In addition, many stakeholders will have great difficulty commenting or fully commenting because the nation is in the middle of a global pandemic constituting a national emergency that is severely affecting business operations of potential commentators. Moreover, EBSA and the Office of Management and Budget ("OMB") will have overlapping 30-day comment periods for a total of six major employee benefit plan-related proposed regulations, a proposed prohibited transaction class exemption, and Information Collection Requests. Without the requested extension, we believe that these circumstances combine to deny the public with adequate notice of the Proposed Rule that would allow interested persons a meaningful opportunity to participate in the rulemaking process. The numerosity of comments that the Department may receive during the existing 30-day period is not sufficient evidence of the volume or substance of comments that would or would not have been filed if EBSA had granted the request for an extension and public hearings. Consequently, we request that the Department extend the comment period for the Proposed Rule until September 28, 2020 and hold public hearings regarding the proposal.

A. Fiduciary Standards for Significant ERISA Plan Investments are of Great Importance and Deserve More Deliberate Public Procedures

The Proposed Rule makes significant changes to standards that the regulated community has relied on for over 40 years. The Department asserts that the Proposed Rule elaborates on the "core principals" of the existing investment duties regulation and codifies sub-regulatory guidance. However, the substantive changes and recordkeeping requirements contained in the Proposed Rule impose new standards of conduct for fiduciaries and new duties regarding investments that encompass environmental, social, corporate governance, or similarly oriented considerations ("ESG").

Since the 1980s, the Department has issued over a dozen Advisory Opinions and Information Letters addressing a fiduciary's consideration of factors providing incidental benefits when investing.⁴ In 1994, the Department issued general sub-regulatory guidance permitting consideration of ESG factors (then "economically targeted investments"), at least as a tie-breaker when selecting between investment options with "comparable risks and returns."⁵ The Department's interpretation of fiduciary considerations with respect to ESG investing has arguably changed in approach with subsequent sub-regulatory guidance while the Department continually acknowledged that its advice did not supersede the regulatory standards of 29 CFR § 2550.404a-1.⁶ Despite administering and managing the nation's retirement plans under different sub-regulatory standards, the public has not previously had the opportunity to comment on ESG investing within benefit plans subject to ERISA.

Public stakeholders with decades of experience with ESG investing and its forebears are in the best position to comment on the potential consequences, increased obligations, and costs that may result from the Proposed Rule. According to the Department, there were approximately 710,000 private defined benefit and defined contribution pension plans in 2017, covering 137.4 million participants and with total assets of nearly \$10 trillion.⁷ The universe of fiduciaries and their service providers that the Proposed Rule potentially affects is both vast and economically consequential. The Proposed Rule directly impacts the duties of fiduciaries for ERISA-regulated employee benefit plans, from those choosing a line-up of investment choices for defined contribution plan participants to health and defined benefit plans with actively managed accounts. Thirty days is insufficient for the public, including the substantial population of affected plans and individuals, to analyze the rule, coordinate, and provide the Department with meaningful input commensurate with the import of the issues under consideration.

B. Simultaneous EBSA and OMB 30-Day Comment Periods Limit Meaningful Public Participation in Rulemaking

The EBSA and OMB have requested public comment on other proposed rules and regulatory submissions with 30-day comment periods that largely coincide with the Proposed Rule. Stakeholders who would like to comment on the Proposed Rule are also likely to be affected by other Department proposals with a 30-day comment period. Set to expire on July 30,

⁴ See e.g., ERISA Advisory Opinion No. 1980-33A (June 3, 1980).

⁵ ERISA Interpretive Bulletin 94-1. The Bulletin, which subsequently resulted in Congressional hearings and proposed legislative changes, is a clear example of the importance of public discourse on these issues.

⁶ See e.g., EBSA Opinion Letter 98-04A; Letter from Alan D. Lebowitz, Deputy Assistant Secretary for Program Operations, Employee Benefit Security Administration, U.S. Department of Labor, to Jonathan P. Hiatt, General Counsel, AFL-CIO (May 3, 2005); ERISA Advisory Opinion No. 2007-07A (Dec. 21, 2007); ERISA Advisory Opinion No. 2008-05A (June 8, 2008); ERISA Interpretive Bulletin 08-1; ERISA Interpretive Bulletin 15-1; and Field Assistance Bulletin 18-1.

⁷ Private Pension Plan Bulletin, Abstract of 2017 Form 5500 Annual Reports (Sept. 2019).

2020, the comment period for the ESG Proposed Rule and related OMB Information Collection Request are sandwiched between comment periods for different proposals affecting employee benefit plans and those who administer them.⁸ Consequently, the public and EBSA will sacrifice an opportunity for meaningful engagement on the Proposed Rule if additional time is not provided.

C. The Persistent COVID-19 Pandemic Substantially Impairs the Public's Ability to Comment on the Proposed Rule before July 30, 2020, Justifying an Extension

The public understandably remains focused on the consequences of the COVID-19 pandemic and the future uncertainty it engenders. On March 13, 2020, President Trump signed the Proclamation on Declaring a National Emergency Concerning the Novel Coronavirus Disease Outbreak.⁹ In addition, the Secretary of Health and Human Services (“HHS”) initially declared a public health emergency on January 31, 2020 and renewed that state of emergency on July 23, 2020 for another 90-days. In July alone, many state and local governments have lifted and then re-imposed restrictions or obligations related to COVID-19. The COVID-19 death count in the United States now exceeds 150,000, and some states are now seeing their health care systems overwhelmed.

The Department has recognized the impact of COVID-19 on the ERISA-regulated community's ability to meet long-standing and routine deadlines, acknowledging that during the COVID-19 pandemic “there may be instances when plans and service providers may be unable to achieve full and timely compliance with claims processing and other ERISA requirements.”¹⁰ With that appropriate recognition, the Department extended the deadline for COBRA administrators to provide notice to a qualified beneficiary by disregarding the public health emergency. The Department has also provided relief for special enrollment periods during the COVID-19 pandemic, claim procedure timelines, and the external review process. In addition to these extensions, the Department has announced a good-faith grace period for required retirement and welfare plan notices that lasts for 60-days after the public health emergency

⁸ *E.g.*, Request for Information on Prohibited Transactions Involving Pooled Employer Plans and other Multiple Employer Plans – Comments due July 20, 2020; Proposed Class Exemption on Improving Investment Advice – Comments due August 7, 2020; Grandfathered Group Health Plans and Insurance Coverage – Comments due August 15, 2020; Proposed Information Collection Request Included in Financial Factors Regulation – Comments due July 30, 2020. Note also that a proposed proxy voting regulation is currently under review by OMB and will also likely have a 30-day comment period overlapping with the comment periods referenced above.

⁹ Proclamation on Declaring a National Emergency Concerning the Novel Coronavirus Disease (COVID-19) Outbreak, issued March 13, 2020, available at <https://www.whitehouse.gov/presidential-actions/proclamation-declaring-national-emergency-concerning-novel-coronavirus-disease-covid-19-outbreak/>.

¹⁰ EBSA, Disaster Relief Notice 2020-01, pages 5-6.

expires. In issuing timeframe extensions, the Department recognized that COVID-19 poses legitimate burdens to administrative compliance with ERISA's obligations.

Those same burdens also affect the public's and plan related-institutions' ability to engage meaningfully with the Department during the current period for public comment. Stakeholders who may wish to comment on the Proposed Rule, including plan sponsors, financial institutions, investment advisors, investment managers, religious and social welfare organizations, tax exempt organizations, ERISA plans, and other impacted parties, have had to consistently monitor and respond to COVID-19, its effects, and related government orders. The impact of COVID-19 on the public and potential commenters cannot be overstated, especially for small businesses and their plan-related service providers.

Finally, the country is dealing with the worst financial crisis and the highest unemployment rate since the Great Depression. Over the last quarter, the Gross National Product has declined at an annual rate of 32.9%. In addition, increased unemployment benefits expire on July 31, 2020, and a nationwide moratorium on evictions expired on July 20, 2020. Given the understated and unintended costs of the Proposed Rule, its implementation in its current form may affect our country's ability to recover from the economic effects of the COVID-19 pandemic. Given the increased costs and adverse effects that the Proposed Rule will cause, we believe that finalizing the Proposed Rule would be contrary to Executive Order 13924 issued on May 19, 2020.¹¹ That Executive Order calls for relief from regulations that will burden the country's economic recovery from the COVID-19 pandemic. The Proposed Rule would impose unnecessary costs and regulatory burdens that exceed its potential benefits when ERISA plan fiduciaries, participants, plan sponsors, and plan service providers are least able to respond effectively.

II. Structure of Regulation – Duty of Prudence & Duty of Loyalty

For the first time, the Department proposes to make a fiduciary's Duty of Prudence and her Duty of Loyalty one in the same. Proposed subsections 2550-404a-1(b)(i)-(v) inextricably intertwine a fiduciary's obligation to consider the "those facts and circumstances that, given the scope of the such fiduciary's investment duties, the fiduciary knows or should know are relevant to the particular investment or course of action" with the requirement that she not "subordinate the interest of the participants and beneficiaries to the fiduciary's or another's interests and has otherwise complied with the duty of loyalty." Simultaneously, this mélange of heretofore separate fiduciary duties require additional analysis by *every* fiduciary for *every* investment to ensure that she has: (1) "evaluated investments and investment courses of action based solely on pecuniary factors;" (2) "that have a material effect;" (3) "on the return and risk of an

¹¹ Executive Order 13924, Executive Order on Regulatory Relief to Support Economic Recovery (May 19, 2020); See also, OMB Memorandum from Russel T. Vought to Heads of Executive Departments and Agencies Re: Implementation of Executive Order 13924 (June 9, 2020).

investment;” (4) “based on appropriate investment horizons;” (5) based on “the plan’s articulated funding” objectives; and (6) based on the plan’s articulated “investment objectives.”

Historically, these duties have been separately addressed, and their merger and the addition of a new six-part, universally applicable and required analysis will impact fiduciary investment decision making beyond consideration of ESG investments. As a result of the Department’s coextensive treatment of the separate fiduciary duties, investment decisions will not only need to address whether the prudence requirement’s appropriate consideration of facts and circumstances occurred, but also whether every particular fact or circumstance satisfies the Duty of Loyalty, determining that the fiduciary considered only factors that meet the definition of a “pecuniary factor.”

In addition, the Proposed Rule sets forth a new special four-part test for “pecuniary factors” regarding ESG related investments. As further discussed below, that additional test will need to be performed on each investment because there is no definition of what type of investment it applies to. The ESG specific “pecuniary factor” test is even more demanding and ambiguous than the first. It requires a determination for each factor as to whether it presents: (1) “economic risks or opportunities;” (2) that a “qualified investment professional;” (2) “would treat as an . . . economic consideration;” (3) which is “material;” (4) “under generally accepted investment theories.”¹²

Thus, the merger of the duties will now require every fiduciary to consider not only whether the proper process has been followed but also a further analysis as to each fact considered. Under the proposed regulation, prudence will require loyalty; and loyalty will require prudence. While some may say that this is a distinction without a meaningful difference, it is important to highlight from the beginning that the Proposed Rule’s new analytical and documentary requirements have broader implications far beyond ESG investing. Those implications are caused by the merger of the fiduciary duties and the general applicability of the universal and ESG “pecuniary factor” tests and additional documentation requirements. Because the proposed regulation goes further than is necessary (if it is necessary at all) to address ESG investing concerns, it also will result in unintended consequences and unintended costs.

III. Duty of Loyalty

While we think that the Duty of Prudence and Duty of Loyalty should be clearly separated, we do believe that that the proposed language for 29 CFR § 2550.404a-1(b)(iv), setting forth the Department’s interpretation of the Duty of Loyalty as requiring that a fiduciary has not “acted to subordinate the interests of the participants and beneficiaries to the fiduciary’s or another’s interests,” is an appropriately complete description of the Duty of Loyalty standard.¹³ This language presents a simple one-pronged test and should replace the

¹² 85 Fed. Reg. at 39127.

¹³ *Id.*

unnecessarily complicated multi-step analysis currently proposed in section 2550.404a-1(b)(iii). The presently proposed language in subsection (iii) should be deleted because it includes additional untested terms that only obscure the clear single-step test set forth above. Specifically, the concepts of: (1) a participant's "financial benefits under the plan;" (2) "unrelated objectives;" (3) "sacrificed" returns or risk; (4) "to promote goals;" (5) "unrelated" to "those financial interests;" and (6) "purposes of the plan" will result in increased costs to plan participants without a commensurate benefit.¹⁴ While such concepts may be important, they are not defined in the existing regulation or ERISA and obscure what would otherwise be a simple and clearer standard against "subordination." As proposed, the more complicated six-prong test does not clarify the Duty of Loyalty's application to particular circumstances. Instead, the cumbersome test will lead to increased decision making costs as fiduciaries deal with the application of needless and potentially misunderstood or misapplied requirements. At the same time, it would facilitate false accusations of Duty of Loyalty breaches without providing any commensurate benefit. The proposed six-prong test will not improve fiduciaries' understanding of the Duty of Loyalty or assist their ability to comply with its requirements because its vagaries are subject to misinterpretation and will promote confusion in the regulated community.

As proposed, the complete language currently set forth in subsection (b)(iv), "[h]as not otherwise acted to subordinate the interests of the participants and beneficiaries to the fiduciary's or another's interest and has otherwise complied with the duty of loyalty" combines with the inappropriately and ambiguously enlarged six-part test described above to offer a circular definition of the Duty of Loyalty.¹⁵ By adding the "otherwise complied with the duty of loyalty" phrase, the Department has set forth an implementing rule for the Duty of Loyalty by "otherwise" requiring compliance with the Duty of Loyalty. Consequently, the additional reference provides no clarity, and this phrase should be deleted from the final rule as well.

Similarly, subsection (v) does not add any additional clarity to the Duty of Loyalty. Requiring that a fiduciary act in accordance with her duties is self-evident. One cannot comply with a standard without acting in accordance with it. The Department should either explain what the phrase "[h]as acted accordingly" adds to an understanding of the Duty of Loyalty's standard or delete it as unnecessarily complicating an axiomatic rule of law.

IV. Pecuniary Factors & Strict Liability Burden Shifting Against Fiduciaries

We believe that the Department's extensive focus on economic considerations being of primary importance for fiduciaries, as set forth in this Notice of Proposed Rulemaking, is appropriate. The Department highlights the required focus on the pecuniary (or financial) factors and the interests of the plan, its participants, and beneficiaries throughout the preamble to the Proposed Rule.

¹⁴ *Id.*

¹⁵ *Id.*

While this focus on financial factors is important, we are concerned that the Proposed Rule shifts the presumption of prudence and loyalty against the fiduciary. In particular, the Proposed Regulation under 29 CFR § 2550-404a-1(b)(1)(ii) requires that all fiduciaries, for all investments, only consider factors that have a (1) “material;” (2) effect on the “return and risk” of an investment; (3) the investment is “based on appropriate investment horizons;” (4) the investment is based on “articulated” funding objectives; and (5) the investment is based on “articulated” investment objectives.¹⁶ These provisions will effectively require each fiduciary to determine whether all of the investment factors she considered were “material” and involved only “return and risk.” The fiduciary must be prepared to show that she did not consider any non-material factors. In addition, the regulation will presumably be used by the Department’s enforcement arms to institute a new recordkeeping requirement that each plan have an “articulated” investment policy. While we believe that the adoption of an investment policy is laudable and a potential indicia of a prudent investment process, a fiduciary does not necessarily breach her Duty of Prudence by making investment decisions despite the lack of an articulated investment policy. The effects and costs of these new investment policy and investment factor screening requirements are neither examined nor quantified in the Proposed Regulation. Failure to comply with them will create a “strict liability” standard, inappropriately shifting the presumption of a fiduciary breach against all fiduciaries and regardless of whether they involve ESG or similar considerations. Thus, we suggest that the language be modified such that the screening of factors and adoption of an investment policy are not threshold requirements for a prudent or loyal fiduciary decision.

The shift of the presumption and global effect on fiduciary investment decisions is also especially pronounced with respect to investments that could, in some way, be characterized as involving ESG or similar considerations. The Proposed Regulation’s recordkeeping requirements do not make a distinction between those investments that were decided based on non-financial factors versus those that were not. In each instance, if an investment can be characterized as involving any “[e]nvironmental, social corporate governance, or other similarly oriented considerations,” whether financially based or otherwise – the recordkeeping requirement arises.

Specifically, if the investment can be characterized as having an ESG or similarly oriented consideration, then a fiduciary must either (1) entirely disregard that element; (2) determine that it is a pecuniary factor and consider that factor in her decision in a quantitative manner only; or (3) determine that the ESG element is not a pecuniary factor, determine whether there is an economically indistinguishable alternative that has no ESG element, and take the ESG element into account only if she can provide the analysis and the documentation required in subsection (c)(2). The prevalence of reporting ESG elements, both in funds labeled as such and those that are not, would make documentation of the burden of proof noted above very difficult

¹⁶ *Id.*

to administer. The Proposed Rule would force every fiduciary to document whether she took pathway 1, 2, or 3 on any such investment. That exponentially increases the number of plans affected by the Proposed Rule, which is not reflected in the proposal's economic analysis. This alone would be good reason to re-propose the regulation.

In the name of prophylactic sunlight, the Department proposes to require fiduciaries to prove a negative – that their motivation for deciding on a particular investment was not based on non-financial considerations. This burden shifting, as referenced above, reaches all investments since the Duty of Loyalty requires a sifting of fiduciary intentions in all cases. This is further highlighted by public corporations' prevalent reporting of ESG factors as material risks.¹⁷

In addition, the requirement to “prove a negative” has the effect of undermining at least two commonly accepted tenets of ERISA. First, the “pecuniary factor” documentation effectively requires a fiduciary to “look through” investment structures that do not otherwise include plan assets (*e.g.*, mutual funds that consider ESG factors). Second, by requiring the documentation (*e.g.*, with respect to any ESG investment line-up choice in an individual account plan), the proposed regulation potentially manufactures a breach of fiduciary duty where none may exist by suggesting that the documentation of decision-making substitute for the exercised judgment of fiduciaries. While the existence of documentation of a prudent process may be evidence of prudence under ERISA, it has never been a necessary requirement of a prudent decision or a loyal decision. If appropriate consideration and the other requirements of a prudent decision under ERISA § 404(a)(1) were met but no documentation was prepared, the investment would historically still be a prudent one. Under the Proposed Regulation, that would not be the case. The Proposed Regulation's documentary requirements are new and costly. The Proposed Regulation's attempt to expose a purportedly small number of breaches of fiduciary duty with respect to non-financially motivated ESG investments will freeze the Duty of Prudence's flexible reliance upon facts and circumstances. Simultaneously, it will increase the cost of decision making because of vague standards that need analysis and unnecessary documentation requirements that switch the presumption of compliance. That presumption shifts, even against a fiduciary who only considers financial factors when investing, whether the factors are ESG inspired financial factors or not.

Another shortcoming is that the Proposed Rule does not actually define what “ESG” means. This leaves the compliance-oriented fiduciary in a no-win situation. She is required to determine and screen her investment decisions based upon the six-point pecuniary factors test referenced above. However, the discerning fiduciary is unsure exactly to which investments the heightened pecuniary factor standard applies. Ignoring ambiguities in the six-point test for a moment, a fiduciary knows what test to apply, but does not know to which investments she must apply it. The fiduciary is left with no option but to screen all investments based upon amorphous

¹⁷ See, *e.g.*, Modernization of Regulation S-K Items 101, 103, and 105, Securities Act Rel. No. 10668, Exchange Act Rel. No. 86614 (Aug. 8, 2019), 84 Fed. Reg. 44358, 44370 (Aug. 23, 2019).

and undefined criteria. Worse, in the event that ESG is defined, that definition will freeze the ESG criteria as they exist today. Defining ESG will necessarily inhibit the market of investment strategy ideas and the evolving value the investment market places on various factors not today considered financial. The result will be an implementation rule that further increases decision-making costs while simultaneously increasing the chance of unmerited litigation and other unintended consequences.

The shifting of the presumption against the fiduciary, the inadvisable requirement of documentation to avoid a fiduciary breach, and the lack of defined terms with respect to the “ESG” triggering events are all contained within the proposed terms of 29 CFR section 2550.404a-1(c). Consequently, we urge the Department to delete that section from the final regulation.

V. ESG Investments Do Not Deserve Heightened Scrutiny Under ERISA

The Department’s assertions in the preamble to the Proposed Rule that ESG related investments produce lower returns and are deserving of heightened scrutiny under ERISA are incorrect.¹⁸ They ignore recent findings by numerous academic and government bodies.¹⁹ Numerous studies show that the ESG factors do have a material financial impact and do not consistently produce lower returns.²⁰ Further, there is recent evidence that ESG oriented funds are outperforming other investments during the COVID-19 pandemic, the basis for which is also supported by academic research.²¹ Not surprisingly, the Securities and Exchange Commission

¹⁸ *Id.* at 39115, 39120-39122, and 39125.

¹⁹ *See, e.g.*, United States Government Accountability Office, GAO-20-530, *Public Companies: Disclosure of Environmental, Social, and Governance Factors and Options to Enhance Them* 9 (2020) (“GAO ESG Report”), available at <https://www.gao.gov/assets/710/707949.pdf>. (finding that institutional investors generally agree that ESG factors can significantly affect long-term returns); *See also*, United States Government Accountability Office, *Retirement Plan Investing*, available at <https://www.gao.gov/assets/700/691930.pdf>.

²⁰ *See, e.g.*, Int’l Monetary Fund, *Sustainable Finance: Looking Farther, In Global Financial Stability Report: Lower For Longer*, at 83 (2019) (“ESG issues can have a material impact on firms’ corporate performance and risk profile, and on the stability of the financial system”); Morgan Stanley, *Sustainable Reality: Analyzing Risk and Returns of Sustainable Funds* (2019), available at https://www.morganstanley.com/pub/content/dam/msdotcom/ideas/sustainable-investing-offers-financial-performance-lowered-risk/Sustainable_Reality_Analyzing_Risk_and_Returns_of_Sustainable_Funds.pdf (“There is no trade-off in the financial performance of sustainable funds compared with their traditional peers. Analyzing the total returns between 2004 and 2018, we find only sporadic and inconsistent differences in performance. Therefore, the returns of sustainable funds were in line with those of traditional funds”); McKinsey & Company, *The ESG premium: New perspectives on value and performance*, February 2020, page 2, available at <https://www.mckinsey.com/~media/McKinsey/Business%20Functions/Sustainability/Our%20Insights/The%20ESG%20premium%20New%20perspectives%20on%20value%20and%20performance/The-ESG-premium-New-perspectives-on-value-and-performance.pdf> (Last Visited on July 21, 2020) (noting a willingness to pay a premium for companies that have positive ESG ratings).

²¹ Financial Times, *Majority of ESG funds outperform wider market over 10 years*, available at <https://www.ft.com/content/733ee6ff-446e-4f8b-86b2-19ef42da3824> (Last Visited 7/15/2020); Morningstar, *US ESG Funds Outperformed Conventional Funds in 2019*, available at <https://www.morningstar.com/articles/973590/us-esg->

and its advisory board have also addressed this issue, finding that ESG related factors are mainstream considerations as public companies are required to report on such factors as material.²² Moreover, prominent investors have also noted the importance of ESG factors as affecting performance.²³ Perhaps even more telling are the recent remarks by Secretary Scalia with respect to investment decisions by the Federal Retirement Thrift Investment Board (the “Board”). While not subject to ERISA, the Board members are subject to the same requirements as the Duty of Loyalty and Duty of Prudence.²⁴ Interestingly, the subjective ESG factors of national security and humanitarian concerns were endorsed by Secretary Scalia as elements that should influence fiduciary decision-making.²⁵ This is because he wanted, consistent with the Administration’s objectives, to exclude investments in Chinese companies by choosing a different international emerging markets index fund. With a familiar ESG analysis, Secretary Scalia reasoned that the Chinese companies included in the index fund “could be subject to sanctions, public protests, trade restrictions, boycotts and other punitive measures that jeopardize their business and profitability.”²⁶

The Department states in the preamble that all investments should be held to the same fiduciary standard.²⁷ However, by classifying and treating investments that merely consider ESG factors as inherently suspect, the Department disregards the balance of the academic research, prominent investors, the Government Accountability Office (“GAO”), Secretary Scalia’s

funds-outperformed-conventional-funds-in-2019 (Last Visited 7/15/2020); The Wall Street Journal, *ESG Investing Shines in Market Turmoil, With Help From Big Tech*, available at <https://www.wsj.com/articles/esg-investing-shines-in-market-turmoil-with-help-from-big-tech-11589275801> (Last Visited 7/15/2020); Gordon L. Clark, Andreas Feiner & Michael Viehs, *From the Stockholder to the Stakeholder: How Sustainability can Drive Financial Outperformance* (2015) (“[E]vidence shows that stocks of firms with a superior sustainability profile deliver higher returns than those of their conventional peers, and that sustainability quality provides insurance-like effects when negative events occur, helping to support the stock price upon the announcement of the negative event.” (footnotes omitted)).

²² Investor-As-Owner Subcomm., Investor Advisory Comm., Recommendation from the Investor-As-Owner Subcommittee of the Sec Investor Advisory Committee Relating to ESG Disclosure at 7-8, 9 (as of May 14, 2020), available at <https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-of-the-investor-as-owner-subcommittee-on-esg-disclosure.pdf>; See also, Jay Clayton, Chairman, Sec. & Exch. Comm’n, Statement on Proposed Amendments to Modernize and Enhance Financial Disclosures; Other Ongoing Disclosure Modernization Initiatives; Impact of the Coronavirus; Environmental and Climate-Related Disclosure (Jan. 30, 2020) (transcript available at <https://www.sec.gov/news/public-statement/clayton-mda-2020-01-30>).

²³ CNBC, *Warren Buffett on judging management*, available at <https://www.cnbc.com/2018/05/08/warren-buffett-heres-how-to-judge-management.html>.

²⁴ 5 U.S.C. § 8477.

²⁵ Letter from Secretary Eugene Scalia, Department of Labor, to Chairman Michael Kennedy, Federal Retirement Thrift Investment Board (May 11, 2020) (online at federalnewsnetwork.com/wp-content/uploads/2020/05/051220_scalia_frtib_letter_FNN.pdf).

²⁶ *Id.*

²⁷ 85 Fed. Reg. at 39115

remarks regarding the Federal Retirement Thrift Investment Board, and other prominent authorities. All types of investments should be subject to the same Duty of Prudence and Duty of Loyalty. A higher standard should not be applied to investments with an ESG type element, and portions of the Proposed Rule that set out that higher standard, including proposed section 2550.404a-1(c), should be removed from the final regulation.

VI. The Department Does Not Retain the “All Things Being Equal Test” (“ATBET”)

A. Proposed Regulatory Language Does Not Give an Exception for the ATBET

While the Department stated in the preamble that it intended to keep the “all things being equal” or “tie-breaker” test,²⁸ the actual language proposed does not do so. It should.

The language in the Proposed Regulation does not state the ATBET. It only provides a recordkeeping requirement if an investment choice is made based on “non-pecuniary” factors or based on “factors such as environmental, social, or corporate governance considerations” (even if such factors are “pecuniary”) because the fiduciary determines that the two investments are “economically indistinguishable.” Proposed subsection 2550-404a-1(c)(2) tells a fiduciary that she must “document specifically why the investments were determined to be indistinguishable and document 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.” However, it does not actually say that if such a determination is properly determined and the required documentation is actually retained that the ATBET applies and the fiduciary’s Duty of Loyalty and Duty of Prudence are satisfied when one of the investments is so chosen. Our dutiful fiduciary knows only that she must consider and document certain factors. Search as she might, nowhere in the regulation is the ATBET set forth in any manner. Most notably, even if the ATBET is added or somehow implied, there is no indication in the proposed language that satisfaction of the ATBET results in a properly met Duty of Loyalty and Duty of Prudence. The final regulation should include an affirmative statement that, if the ATBET is met, the Duty of Prudence and Duty of Loyalty will be satisfied.

B. Subordination Standard Permits ATBET

The Proposed Regulation’s Duty of Loyalty standard set forth in proposed section 2550-404a-1(b) requiring that a fiduciary “has not acted to subordinate the interests of the participants and beneficiaries to the fiduciary’s or another’s interests . . .” suggests a more precise interpretation of the “sole and exclusive benefit” rule. It is important to note that the retention of the ATBET is even more appropriate under the anti-subordination standard. Assuming that a

²⁸ 85 Fed. Reg. at 39117 (“Nonetheless, because ties may theoretically occur and the Department does not presently have sufficient evidence to say they do not, the Department proposes to retain the current guidance’s “all things being equal” test.”).

“tie” occurs and a “non-pecuniary” factor is considered in deciding to make one investment over the other, one might argue (as Sitkoff incorrectly does)²⁹ that the sole and exclusive benefit rule would not permit a fiduciary to choose one investment over the other based on a collateral benefit because the fiduciary may “solely” consider the interests of the participants, and no other. However, if the Department’s interpretation of the sole and exclusive benefit rule is such that a fiduciary may satisfy her Duty of Loyalty by not subordinating any other interest to that of the participants, then the application of the ATBET does no harm to the Duty of Loyalty. While a different collateral factor may have been considered, the consideration of that “other” factor did not result in the subordination of the participants’ interests to that of the collateral benefit because all things were equal in any event. Having agreed that the Duty of Loyalty is best expressed as the duty not to subordinate the participants’ interests to any other interest, the ATBET is free to operate within that Duty of Loyalty if one can agree on what is required for two investments to be considered a “tie”.

VII. The Proposed Criteria for Economically Indistinguishable Investments Should Not Be the Trigger for the ATBET

A. The Economically Indistinguishable Investments Criterion is a Departure from the Prior Sub-Regulatory Guidance

The criterion set forth in the Proposed Regulation to determine whether the ATBET should be applied is a significant departure from the Department’s prior guidance. Interpretative Bulletin 2015-01 is the existing guidance under which the regulated community operates. Contrary to the assertion in the preamble, the Proposed Rule suggests that under Interpretative Bulletin 2015-01 the ATBET would not apply unless two investments were found to be “economically indistinguishable” as determined under criteria newly described.³⁰

While maintaining that the Department intends to retain the ATBET but not actually including it in the language of the regulation itself, the Proposed Regulation newly describes an impossible threshold standard for application of the ATBET. Interpretative Bulletin 2015-01 superseded Interpretative Bulletin 2008-01 and set the ATBET threshold standard as requiring:

“consideration of the expected return on alternative investments with *similar* risks available to the plan . . . an investment will not be prudent if it would be expected

²⁹ Max Schanzenbach & Robert Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 Stan. L. Rev. 408–09 (2020) (the Department cites to the law review four times in the Proposed Rule).

³⁰ Even Sitkoff, one whom the Department’s reasoning partially relies, disagrees with the department on this point. *Id.* at 408 (in reference to Interpretative Bulletin 2015-01 stating that “[t]he Department has taken the position, since embraced by the Freshfields Report and others, that if a pension trustee has two investment options with otherwise identical risk and return attributes, the trustee may consider collateral benefits as a tiebreaker without violating the duty of loyalty.”).

to provide a plan with a lower rate of return than an available alternative investment with *commensurate* degrees of risk or is riskier than alternative available investments with *commensurate* rates of return.

The fiduciary standards applicable to ETIs are no different than the standards applicable to plan investments generally.”³¹

Thus, existing Department guidance speaks in terms of comparing the economic characteristics of two investments as *similar* and with *commensurate* risks and returns. In stark contrast, the preamble to the Proposed Rule sets very specific criteria which are, as a practical matter, unobtainable. In fact, the Department suggests that such ties, which have for decades formed the basis of the regulatory guidance in this area, are mythical creatures that do not exist – “unicorns.”³²

Specifically, the preamble remarks that it is not sufficient for such investments to be “highly correlated” or “otherwise similar.” Instead, in order for two investments to trigger the ATBET, they must be “indistinguishable” or the “same” using only “objective measures” with respect to the following: (1) “the same target risk- return profile or benchmark;” (2) “the same fee structure;” (3) “the same performance history;” (4) “the same investment strategy;” (5) “a different underlying asset composition;” (6) the same “function . . . in the overall context of the fund portfolio;” and (7), the same performance “going forward . . . based on external economic trends and developments.”³³ The simple juxtaposition of these descriptions makes clear the differences between the existing sub-regulatory guidance and the Proposed Rule and the degree to which the Proposed Rule is not a codification of existing sub-regulatory guidance to the regulated community.³⁴ Interpretive Bulletin 2015-01 also puts the comparison in the context of the overall plan portfolio while the Proposed Regulation’s criteria require clairvoyance about future performance by reference to data that only comes from an ex-post review provided in the comfort of a law and economics analysis, which is divorced from the actual operations of the market. At the time of the investment, it is simply not possible to know how the investment will perform going forward.

³¹ 85 Fed. Reg. 39119.

³² *Id.* at 39119, FN 22.

³³ *Id.* at 39119.

³⁴ We note that I Interpretive Bulletin 2015-01 replaced Interpretive Bulletin 2008-01 and that Field Assistance Bulletin 2018-01 was issued by the national EBSA office to the regional enforcement offices to provide its views with respect to the still currently effective Interpretive Bulletin 2015-01. While each referenced the phrase “economically indistinguishable” they did so in the context of the impact on a plan as a whole, considering “qualitative” factors, and not requiring the extreme “objective” criteria described in the preamble to the Proposed Rule. See Interpretive Bulletin 2008-01, 73 Fed. Reg. 61735.

B. The Proposed Criteria Ignores Imperfect Market Information and the Necessary Consideration of Subjective Analyses

Contrary to assumptions made in economic models, the financial markets with which a fiduciary must deal do not operate with perfect information. The determination of an “economically indistinguishable” investment is not, as a practical matter, possible under the criteria described in the preamble to the Proposed Rule because the information necessary to make such a determination cannot be made on a purely objective basis. This is because risk and return analyses are based upon subjective interpretations using imperfect, incomplete, or even sometimes contradictory information. Given the wide array of investment professionals with idiosyncratic bits of information available to them and differing views on how objective information should be interpreted, coinciding with an almost innumerable number of investment opportunities, it is inevitable – not rare – that investment professionals would perceive some two investments as having “equal economic value” to a plan.

Even determining the “objective” factors that a fiduciary may consider with respect to investments that involve “[e]nvironmental, social, corporate governance, or other similarly oriented considerations” is necessarily subject to unknown and subjective determinations. As discussed above, a fiduciary may only consider “ESG” “pecuniary factors” if they are: (1) “economic risks or opportunities;” (2) that a “qualified investment professional” would; (3) treat as “economic considerations;” (4) that are “material” under; (5) “generally accepted investment theories.”³⁵ Each of these criteria is undefined in the Proposed Regulation and also a matter of subjective evaluation. The analysis of who is a qualified investment professional and which one of them may consider or how many of them must consider an investment theory to be generally accepted is unknown and requires a subjective evaluation. If materiality is a factor that such a person would take into consideration when making an investment decision, does the fact that an undisputedly qualified individual takes a particular factor into account automatically make that consideration material?

We urge the Department to consider that the requirement of “objective” data and the qualitative terms and evaluations necessary to apply the terms of the proposed standard inherently make those determinations subjective. The proposed standard itself does not clarify the Duty of Loyalty or the Duty of Prudence to make it easier, less time consuming, or cheaper to apply than the standard in place today. Not only does the Proposed Rule fail to quantify any harm that may be occurring now with respect to ESG investments, but the implementing rule only gives rise to additional necessary subjective determinations. The Proposed Rule will give rise to additional costs to plans and their participants as a result. These costs, along with the additional costs caused by the universal screening requirements described above, are not identified or quantified in the economic analysis. Again, the Department’s failure to identify and

³⁵ 85 Fed. Reg. at 39127 (amending 29 CFR § 2550-404a-1(c)(1)).

quantify these costs impairs the ability of the public to meaningfully participate in the rulemaking.

VIII. Inadequate Economic Analysis

The economic analysis set forth in the Proposed Regulation does not adequately meet the requirements of the Administrative Procedures Act and Executive Order 12866.³⁶ The Proposed Regulation vastly underestimates the direct costs of the regulation and overestimates its benefits. It also fails to consider the costs of unintended consequences that would result from the implementation of the Proposed Regulation.

The Department has represented that the Proposed Regulation is economically significant. Assuming that the Department does not believe the Proposed Regulation has other adverse effects, that determination likely means that the Proposed Regulation includes novel policy issues and/or will have an economic impact of more than \$100 million per year.³⁷ However, the Department's estimate of the cost of the Proposed Regulation is dependent upon the fact that it does not believe that many plans will be out of compliance. Conversely, this suggests that there is no need for regulation because compliance has already largely been obtained. And, too, it suggests that the economic impact of the Proposed Regulation will not be more than \$100 million per year. With respect to novel policy issues, the Department contends that it is merely codifying sub-regulatory guidance, so no novel policy issues exist. Because the Department has not explained the basis for its conclusion that the economic impact of the regulation is significant, the Department has not adequately given notice to the public such that it can meaningfully participate in commenting on the proposal.

The Department's economic analysis also fails to consider all the costs of the proposed regulation. For example, the Department does not consider the cost to all plans (not just those that make investments in ESG based on non-financial factors). In each case and as discussed above, plan fiduciaries will need to ascertain whether only "pecuniary factors" were considered in making any investment *and* whether any ESG "type" factors are merely considered (but not necessarily determinatively considered) with respect to any investment decision. Then, yet another analysis will need to be done for each investment as to whether those factors are special ESG qualifying "pecuniary factors" with respect to only "economic risks or opportunities,"

³⁶ 5 USC § 553; Executive Order 12866, Executive Order on Regulatory Planning and Review (Sept. 30, 1993).

³⁷ See section 3(c)(f)(1)-(4) of Executive Order 12866 defining an "economically significant" regulation requiring specific economic analysis as a regulation that will: "(1) Have an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities; (2) Create a serious inconsistency or otherwise interfere with an action taken or planned by another agency; (3) Materially alter the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) Raise novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in this Executive order."

“qualified investment professional[s]” “treating” “material economic considerations” “under generally accepted investment theories.” This is an especially daunting and costly task given the rising concern in the market place with material ESG factors disclosed in public filings. None of the costs associated with that necessary effort are considered in the economic analysis.

Moreover, the Department fails to consider any costs associated with unintended consequences. The Proposed Regulation is not merely codifying already existing guidance. As discussed above, the Proposed Regulation significantly changes the standard for ESG investing. That change, real or perceived, is likely to discourage investments that include ESG factors. Based on research that ESG investing determined on financial factors produces long term gains not otherwise available, the chilling effect on such investing will be a cost of the regulation that is not considered or quantified in the economic analysis. The Proposed Rule will “chill” or dissuade fiduciaries from making appropriate, prudent, and loyal ESG investments that would give higher returns than other investments. That lost opportunity cost should be quantified and factored into the economic analysis, but it is not.

The Department also does not consider the chance that individual participants will lower their elective deferrals into their plans if they are not able to take advantage of ESG investment options. Similarly, plan sponsors who feel it is important to include ESG investments in their defined benefit plans may fail to form new plans or freeze existing plans if they are not able to make investments that take advantage of ESG factors. While it may be said that these consequences are immaterial to a legal determination of ERISA’s Duty of Loyalty, it is important to consider that the purpose of the tax advantaged status of benefit plans is to increase retirement savings and welfare plan benefits. If a consequence, unintended though it may be, of the Proposed Regulation’s unnecessarily complicated and burdensome requirements is to lower retirement savings and benefits, then that cost should be quantified. Such costs would likely outweigh any of the unquantified benefits of the Proposed Regulation.

We believe that the Department does not currently have enough information to determine the costs or benefits of the Proposed Regulation. In order to do so, the Department should hold public hearings and take advantage of the Request for Information procedures. Until it has done so, the Department simply does not have enough information to adequately prepare an economic analysis.

IX. Effective Date

Given the potential unintended consequences, increased costs associated with the Proposed Regulation, implementation during the COVID pandemic and the worst financial crisis since the Great Depression, as well as the significant changes in guidance that it would entail as described above, we believe that the Department should delay the effective date for at least year after publication of the final regulation in the Federal Register. Plan fiduciaries and their service

providers will need at least that much time to review existing investments and institute investment and record keeping procedures in order to comply with the new regulation.

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Again, we very much appreciate the Department's hard work in preparing the Proposed Regulation and appreciate the opportunity to comment. If you think it helpful, we would welcome the opportunity to further discuss the issues.

Very truly yours,



James V. Cole II