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Financial Factors in Selecting Plan Investments

Comment On: EBSA-2020-0004-0002
Financial Factors in Selecting Plan Investments

Submitter Information

Name:

General Comment

Dear Director Canary:

On behalf of the people of the United States, we thank you for the opportunity to submit comments on the notice of proposed rulemaking entitled “Financial Factors in Selecting Plan Investments” (“Proposal” or “NPR”). Integrating environmental, social, and governance (ESG) factors into investment activities is essential to fulfilling fiduciary obligations to engage in appropriate risk management. We believe that the Proposed Rule fundamentally misconstrues the importance and role of ESG integration in reducing risk and increasing returns. Further, the Proposed Rule is likely to lead to confusion and costs for retirement plan fiduciaries. We, therefore, urge you to retain existing guidance and not move forward with a final rule.

Despite the Proposed Rule’s stated goal of providing clarity for ERISA fiduciaries, it instead creates confusion due in part to a failure to distinguish ESG integration and Economically Targeted Investing (ETI). ESG integration is the consideration of risk factors as part of prudent fiduciary management and a strategy that takes these factors into account in investment actions. ETIs are investments that aim to provide financial returns as well as collateral, non-financial benefits. For example, ETIs often advertise job creation or climate impact as goals of the investment. [1]

ESG Integration

The Proposed Rule states that ERISA fiduciaries have fulfilled their obligations if they have “selected investments and/or investment courses of action based solely on pecuniary factors” and that “ESG factors and other similar factors may be economic considerations.” In fact, there is now an extensive body of research that makes clear that ESG factors are material investment considerations. [2] As such there exists a sound basis for integrating ESG factors into investment

actions.

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

The “all else being equal test”

We are highly concerned that the Proposed Rule inappropriately creates new burdens for fiduciaries under the “all else being equal test” that will lead to unnecessary costs for plan participants. It also creates confusion about what activities the DOL is attempting to regulate.

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

The Proposed Rule proposes the retention of the “all things being equal” test but adds new and costly record keeping requirements for fiduciaries to document their conclusion that multiple options are equal and that it is, therefore, appropriate to make a decision based on collateral benefits. Below is a chart detailing three examples of traditional ETFs and their ESG counterparts. Highlights below indicate outperformance. As shown, funds that integrate ESG factors into their plans largely outperform their traditional counterparts, indicating that ESG factors can indeed be a material rather than non-pecuniary factor.

Out of the 24 instances of comparison between traditional ETFs and their fossil-free ESG counterparts, ESG ETFs outperformed traditional ETFs 21 out of 24 times, or 88% of the time in the examples above. Not only do the ESG funds outperform their counterparts, they foster societal benefits, creating a win-win scenario for investors who are interested in investing their values with ESG.

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

Institutional investors have a duty to act in the best, long-term interests of their beneficiaries. In this fiduciary role, we believe that ESG factors may be financially material, and integrating ESG factors is core to investment decision-making. If the Proposed Rule goes into effect, it will undermine fiduciaries’ ability to act in the long-term best interest of their beneficiaries. As such, we urge you to you to allow the existing guidance to remain in effect and not move forward with a final rule.