



December 13, 2021

Via <http://www.regulations.gov> and e-mail

The Honorable Ali Khawar
Acting Assistant Secretary
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

Attention: Prudence and Loyalty in Selecting Plan Investments and Exercising
Shareholder Rights
RIN 1210-AC03

Dear Acting Assistant Secretary Khawar:

AARP, on behalf of our 38 million members and all older Americans nationwide, appreciates the opportunity to submit comments on the Department of Labor's proposal concerning the use of environmental, social and governance (ESG) factors in selecting plan investments and exercising proxy voting and other shareholder rights.

A major priority for AARP is to assist Americans in accumulating and effectively managing adequate retirement assets to supplement Social Security. Many of our members currently participate, or have participated, in employer-sponsored retirement plans. Participants and beneficiaries rely on these plans for their long-term financial security. Prudent selection of investments and exercise of shareholder rights are crucial fiduciary responsibilities which impact the financial success of the plan and the retirement security of the participants and beneficiaries. Fiduciaries must exercise their duties for the exclusive benefit of, and with complete and undivided loyalty to, plan participants and beneficiaries.

A. When Fiduciaries Select An Investment Or Exercise Proxy Voting Rights, They Must Meet ERISA’s Stringent Fiduciary Standards.

In enacting the fiduciary responsibility provisions of ERISA, Congress codified several core principles developed in the common law of trusts.¹ ERISA’s fiduciary responsibility rules impose the twin duties of care and loyalty on any person who has or exercises discretionary authority over the operation of employee benefit plans. One of the key floor statements leading to ERISA’s passage noted that among Congress’s objectives was “to establish uniform fiduciary standards to prevent transactions which dissipate or endanger plan assets”²

ERISA’s fundamental fiduciary obligations instruct that a plan fiduciary

act for the exclusive purpose of “(i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan;”³

act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent [person] acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;”⁴

diversify the investments of the plan “so as to minimize the risk of large losses, unless in the circumstances it is clearly prudent not to do so;”⁵ and

discharge all of their duties with respect to a plan “solely in the interest” of the plan’s participants and beneficiaries.⁶ Courts have interpreted this to mean that fiduciaries must act “with an eye single to the interests of the

¹ See *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101 (1989) (“ERISA abounds with the language and terminology of trust law.”).

² 120 Cong. Rec. S15,737 (statement of Sen. Williams, Aug. 22, 1974), *reprinted in* 1974 U.S.C.C.A.N. 5177, 5186.

³ ERISA §404(a)(1)(A), 29 U.S.C. §1104(a)(1)(A).

⁴ ERISA §404(a)(1)(B), 29 U.S.C. §1104(a)(1)(B).

⁵ ERISA §404(a)(1)(C), 29 U.S.C. §1104(a)(1)(C).

⁶ ERISA §404(a)(1), 29 U.S.C. §1104(a)(1).

participants and beneficiaries”⁷ and “with complete and undivided loyalty to the beneficiaries.”⁸

Accordingly, ERISA’s fiduciary obligations require that the interests of plan participants and beneficiaries are paramount. AARP appreciates that, in its proposal, the Department has stressed that these fiduciary obligations prohibit subordinating the interests of the participants and beneficiaries in their retirement income and financial benefits under the plan to other objectives and may not sacrifice economic returns to promote ancillary goals. To be clear, we support the Department’s position that does not permit fiduciaries to sacrifice investment return, increase risk, and/or pay higher fees and expenses merely so the plan can invest in an ESG investment. The Department should emphasize that this proposal does not establish a fiduciary standard that is less stringent than the statutory standard in ERISA Section 404.

B. ESG Factors Can Be Used In The Selection Of Investments Where They Are Material To Evaluate Risk, Return, And Fees And Expenses.

As the Department recognizes throughout its proposal, the duty of loyalty is one of ERISA’s fundamental bedrock principles to protect participants and beneficiaries. The use of ESG factors in the selection of investments should be consistent with the duty of loyalty. Indeed, these factors should be evaluated as a matter of course if they impact a fiduciary’s analysis of the economic and financial merits of a particular investment, competing investment choices, or investment policy, just like a myriad of other factors that may be material to investment value and risk and return. As part of a risk-management process, these ESG factors could include factors such as sustainable practices which manage liabilities better than others; recognition of new opportunities due to environmental changes; and identification of well-managed companies that may be better positioned to grow over the long term.

AARP notes that the Department’s proposal generally does not require any special documentation when the fiduciary considers ESG factors. However, the

⁷ *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982).

⁸ *Donovan v. Walton*, 609 F. Supp. 1221, 1228 (S.D. Fla. 1985), *aff’d*, 794 F.2d 586 (11th Cir. 1986) (quoting *Freund v. Marshall & Ilsley Bank*, 485 F. Supp. 629, 639 (W.D. Wis. 1979)).

Department should remind fiduciaries that procedural prudence is still required and the fiduciaries' actions will be measured by whether the fiduciaries "at the time they engaged in the [] transactions, employed the appropriate methods to investigate the merits of the investment and to structure the investment."⁹ Procedural prudence might include determining compliance with the plan's investment policy; documentation of the fiduciaries' investigation of investment choices; the track record of investment products using ESG factors; differences between fees and expenses of alternative investment choices;¹⁰ a fund's ESG factors, its rating using such factors, and its portfolio;¹¹ and the fiduciaries' reliance on expert advice, as appropriate, when considering ESG factors.

C. When A Fiduciary Selects A QDIA, The Fiduciary Must Meet ERISA's Stringent Fiduciary Standards, Whether Or Not The Fiduciary Considers ESG Factors.

1. Participants who are automatically enrolled and placed in default investment options remain in the default fund at the default contribution rate.

Subsequent to the Department's guidance on Qualified Default Investment Alternative ("QDIA"), the large majority of 401(k) plans have instituted auto-enrollment¹² and default investments for those participants who were automatically enrolled.¹³ Automatically enrolled new entrants typically remain entirely in the

⁹ *Donovan v. Mazzola*, 716 F.2d 1226, 1232 (9th Cir. 1983); *see also, e.g., DiFelice v. U.S. Airways*, 497 F.3d 410, 420 (4th Cir. 2007); *GIW Indus., Inc. v. Trevor, Stewart, Burton & Jacobsen, Inc.*, 895 F.2d 729, 733 (11th Cir. 1990); *Katsaros v. Cody*, 744 F.2d 270, 279 (2d Cir. 1984); *Donovan v. Cunningham*, 716 F.2d 1455, 1467 (5th Cir. 1983).

¹⁰ In its regulatory analysis, the Department recognizes that ESG investing can result in lower returns. 86 Fed. Reg. 57,272, 57,290-91 (Oct. 14, 2021).

¹¹ Wharton Magazine, *A Sound Plan for Sustainable Investing?* (Fall/Winter 2021) <https://magazine.wharton.upenn.edu/issues/fall-winter-2021/a-sound-plan-for-sustainable-investing/> ("ESG ratings are strongly indicative of how well companies do on several fronts").

¹² Olivia S. Mitchell & Stephen Utkus, *Target Date Funds and Portfolio Choice in 401(k) Plans*, at 1-2, Nat'l Bureau of Econ. Research Working Paper 26684 (Jan. 2020), <https://www.nber.org/papers/w26684> (by 2018, two-thirds of new 401(k) plan entrants were automatically enrolled).

¹³ *Id.* (80 percent of 401(k) plans offered these target date funds (TDFs), with these funds the dominant choice for default investments). Indeed, in plans with new-hire automatic enrollment, 78.7 percent of new participants adopted TDFs, representing a substantial default effect. *Id.* at 3. *Accord*, David Blanchett,

default fund, at rates ranging from 46 to 90 percent.¹⁴ Moreover, participants have a greater tendency to accept the default contribution rate, and do not increase their contribution rates even as their paychecks increase.¹⁵ Finally, fiduciaries may distribute funds from the participants' accounts without their consent if the plan provides that any mandatory distribution of a nonforfeitable accrued benefit of less than \$5,000 but more than \$1,000 will automatically be transferred to an individual retirement account (IRA), absent a contrary election.¹⁶ Participants' passive involvement with their plan – at all stages – demonstrates the importance of the fiduciaries' choice of a QDIA.

2. If fiduciaries consider ESG factors when selecting a QDIA, that selection must be judged under ERISA's stringent fiduciary standards, not a lower standard.

Fiduciaries should not select, and participants should not be placed into, a default investment if there is greater risk, potentially lower returns, and/or higher fees and expenses than comparable potential default investment options. Thus, the Department should emphasize that “a fiduciary may not subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to other objectives” and may not sacrifice economic returns to promote ancillary goals.” Quite simply, the fiduciary cannot accept reduced returns, greater risks, or higher fees and expenses to secure a collateral benefit, no matter how worthy the result. The Department should clearly state that when a fiduciary chooses a fund as a QDIA using ESG factors the fiduciary's action will

Michael S. Finke & Jonathan Reuter, *Portfolio Delegation and 401(k) Plan Participant Responses to COVID-19*, at 1, Nat'l Bureau of Econ. Research Working Paper 27438 (June 2020), <https://www.nber.org/papers/w27438>. Significantly, more than 20 percent of participants already in the plan adopted TDFs when these funds were introduced. Olivia S. Mitchell & Stephen Utkus, *Target Date Funds and Portfolio Choice in 401(k) Plans*, at 3.

¹⁴ *Id.* at 10. *Accord*, David Blanchett, Michael S. Finke & Jonathan Reuter, *Portfolio Delegation and 401(k) Plan Participant Responses to COVID-19*, at 2 (participants rarely make changes to their 401k accounts).

¹⁵ Gopi Shah Goda, Matthew Levy, Collen Flaherty Manchester, Aaron Sojourner, & Joshua Tasoff, *Do Defaults Have Spillover Effects? The Effect of the Default Asset on Retirement Plan Contributions?*, at 2, Nat'l Bureau of Econ. Research Working Paper RRC NB18-12 (Jan. 2019), <https://www.nber.org/programs-projects/projects-and-centers/retirement-and-disability-research-center/center-papers/rrc-nb18-12>.

¹⁶ Code §401(a)(31)(B).

be judged by the same ERISA fiduciary standard as a QDIA chosen without using ESG factors; put another way, the fiduciary will not be judged by a lower standard.

In short, AARP agrees that funds should not be excluded from treatment as QDIAs merely because the fiduciaries expressly consider ESG factors, as long as the funds are prudent based on a consideration of all of their financial attributes and meet the protective standards set out in the Department's QDIA regulation.¹⁷

D. AARP Submits That The Department Should Clearly State That The “Equally Serve The Financial Interests Of The Plan” Standard Is Not A Lower Standard Than ERISA’s Current Fiduciary Standard.

1. The Proposal Should Distinguish Between Defined Benefit Plans And Participant-Directed Individual Account Plans.

In a defined benefit plan, the determination of whether a particular investment is prudent is not necessarily restricted to the prudence of each investment in isolation.¹⁸ To some extent, the prudent person standard under ERISA integrates the “modern portfolio theory” of asset management,¹⁹ particularly in retirement plans that are not individual retirement account plans.

¹⁷ A plan could offer an ESG-designated fund as one among alternative investments, assuming of course the fiduciaries have done their due diligence. In July 2019, Vanguard reported that of the 1,900 plans for which it was the recordkeeper, 9% offered a socially responsible domestic equity option; large plans (with over 5,000 participants) were the most likely to offer such an option with 19% of them doing so. Thus, of the 5 million participants served by Vanguard, 23% of them were offered this option. Out of this group, only 4%, or 50,000 participants on Vanguard’s recordkeeping platform elected to invest in socially responsible equity funds. Principles for Responsible Investment, *Private Retirement Systems And Sustainability: United States | 2020*, at 16, <https://www.unpri.org/download?ac=10854>. Other surveys show similarly small numbers of plans offering ESG options with an even smaller uptake by participants. *Id.*

¹⁸ 29 C.F.R. §2550.404a-1(b)(1)(i); see *Donovan v. Walton*, 609 F. Supp. 1221, 1243 (S.D. Fla. 1985) (stating “[t]he Department [of Labor] emphasized that the prudence of an investment decision should not be judged without regard to the role that the proposed investment or investment course of action plays within the overall plan portfolio”), *aff’d*, 794 F.2d 586 (11th Cir. 1986).

¹⁹ Comment, *Making a Prudent Response to a Tender Offer: The Corporation Trustee’s Dilemma*, 32 AM. U. L. REV. 839 n.108 (1983).

Accordingly, to evaluate an investment, a fiduciary would give appropriate consideration “to those facts and circumstances that, given the scope of such fiduciary’s investment duties, the fiduciary knows or should know are relevant to the particular investment or investment course of action involved, including the role the investment or investment course of action plays in that portion of the plan’s investment portfolio with respect to which the fiduciary has investment duties.”²⁰ “[A]ppropriate consideration” includes a determination by the fiduciary that the investment is reasonably designed, as part of that portion of the plan’s portfolio managed by the fiduciary, “to further the purposes of the plan, taking into consideration the risk of loss and the opportunity for gain (or other return) associated with the investment.”²¹

Where an investment is part of a pension plan’s broader portfolio, courts have generally found that the investment in question is prudent.²² In contrast, a court rejected the application of modern portfolio theory to participant-directed defined contribution plans, holding that each investment option must itself be prudent.²³ The court distinguished this situation from that in a defined benefit plan, in which the fiduciary is controlling the investment, to conclude that the fiduciary cannot assume that a participant will construct a diversified portfolio from the total mix of investment options offered.²⁴ Indeed, studies support the court’s distinction.²⁵

²⁰ 29 C.F.R. §2550.404a-1(b)(1).

²¹ 29 C.F.R. §2550.404a-1(b)(2)(A).

²² *Laborers Nat’l Pension Fund v. Northern Tr. Quantitative Advisors*, 173 F.3d 313, 319–23 (5th Cir. 1999) (relying on DOL regulation in concluding that an investment manager acted prudently in investing pension plan assets in derivatives as the manager gave appropriate consideration to the plan’s guidelines and overall objectives, as shown in part by the fact that the disputed investment was reasonably designed to serve as a hedge against possible interest-rate hikes); *California Ironworkers Field Pension Tr. v. Loomis Sayles & Co.*, 259 F.3d 1036, 1044 (9th Cir. 2001) (finding that the fiduciary had not acted imprudently where fiduciary gave consideration to the role the challenged investment played in a pension plan’s broader portfolio); *see also* *Chao v. Moore*, 2001 U.S. Dist. LEXIS 9012 (D. Md. June 15, 2001) (endorsing the modern portfolio theory of investing).

²³ *DiFelice v. U.S. Airways*, 497 F.3d 410, 423–24 (4th Cir. 2007); *see also* *Stegemann v. Gannett Co.*, 970 F.3d 465, 476-478 (4th Cir. 2020) (reiterating the holding of *DiFelice* and applying it).

²⁴ *DiFelice v. U.S. Airways*, 497 F.3d 410.

²⁵ See Section C.,1., above.

The Department’s rationale for the “equally serve the financial interests of the plan” standard may make sense for defined benefit plans and defined contribution plans that are not participant directed.²⁶ Selecting varying investment options, including ones that consider and weigh ESG factors, as material to investment value and risk and return, to identify responsible, well-managed companies that may create long term financial value, or as a tie-breaker, may be an appropriate part of a mix of investments in order to construct a broad portfolio.

However, the Department’s rationale does not apply when it comes to a QDIA. A participant who is automatically enrolled into a plan and defaulted into a QDIA is not constructing a portfolio constructed of various investments. Given that participants who are automatically enrolled into a plan tend to have passive involvement with the plan, the fiduciaries’ choice of a QDIA must be made with extra care and should be particularly protective of what may – at least initially if not longer – be the participants only investment, given risks and return over the long-term investment horizon.²⁷

Consequently, the proposal’s “equally serve the financial interest of the plan” should not be applied in the same way to participant-directed individual account plans, but is more appropriate only to defined benefit plans and defined contribution plans which are not participant-directed.

²⁶ It seems very unlikely that, even under the Department’s new, relaxed standard, there could ever really be two investments that “equally serve the financial interests of the plan” and thus a need for a tiebreaker. Indeed, part of a fiduciary’s job is to weigh various investment alternatives to determine which ones best meet the financial objectives of the retirement plan.

²⁷ The QDIA regulation at 29 C.F.R. §2550.404c-5 (Fiduciary Relief for Investments in Qualified Default Investment Alternatives) absolves a plan fiduciary that complies with the regulation of liability for any loss, or by reason of any breach, that occurs as a result of such investment in a QDIA. 72 Fed. Reg. 60,452 (Oct. 24, 2007). As to this proposal, see RIABIZ, *Big effect of DOL's proposed undoing of Trump-era 401(k) ESG investing chill is to permit ESGs TDFs as default option where BlackRock and Natixis have products* (Oct. 13, 2021), <https://riabiz.com/a/2019/6/5/oisins-bits-sierra-club-slams-larry-finks-lip-service-to-green-future-pre-vc-raise-smartria-is-winning-an-ria-a-day-brian-hamburger-counters-what-happens-when-the-tide-goes-out-eric-clarke-pairs-up-with-raj-udeshis-hiddenlevers> (“this rule is key to mainstreaming ESG,” because the importance of QDIAs is that the [funds] become a “safe harbor,” hence the employer is absolved of liability should the QDIA absorb investment losses).

2. The DOL Should Clarify That The Proposal’s “Equally Serve The Financial Interest Of The Plan” Standard As It Applies To A QDIA Is Not Intended To Lower The Current ERISA Fiduciary Standard.

As the above cases demonstrate, the standard for a QDIA should not be any less than the current prudent standard because participants are relying on the fiduciary to choose an investment that will achieve their retirement goals over their duration of participation in the plan. For example, some studies have shown that target date funds have been successful for participants in providing a retirement investment which provides steady growth with minimal risk, appropriate diversification, and lower fees and expenses. We see no reason to suggest a change that would lower the current fiduciary standard that seems to be working well for participants.

Given that the proposal’s “equally serve the financial interest of the plan” standard may be confusing as it applies to a QDIA, we recommend the DOL rely on and clarify the original “all things being equal” standard as one that is more easily implemented and understood by fiduciaries, investment managers, and participants as consistent with the current fiduciary framework.

3. Robust Disclosure Is Necessary If The Department Permits Fiduciaries To Choose A QDIA Based On Collateral Benefits.

If the Department allows fiduciaries to choose a QDIA based on collateral benefits, the Department should provide additional, clear guidance as to the disclosure requirement. AARP maintains that it would not be sufficient disclosure to cross-reference information in other fact sheets and/or prospectuses for the particular investment option; moreover, mere posting of the disclosure on an internet website is inadequate.²⁸

The disclosure should be on a separate page and provided at the time a participant joins the plan. In order to provide accountability, transparency, and as a matter of best practices, the Department should require that the fiduciaries disclose the specific ESG and other criteria that they used, the reason for the fiduciaries’

²⁸ AARP submits that if the Department permits electronic disclosure of the QDIA choice based on a collateral benefit, the disclosure must be separate and the participant must electronically initial the bottom of the disclosure before the QDIA takes effect.

decision to use the tiebreaker and an explanation of the collateral benefit. We support the Department’s requirement that the disclosure materials prominently display “the collateral-benefit characteristic of the fund.” In addition, the proposal should provide that, upon the written request of a participant or beneficiary to the plan administrator, the plan must disclose the alternative investments that were not chosen in the tiebreaker, their identifying information such as type of asset class as well as fees and expenses, and an explanation of why these alternatives were not chosen.

E. A Fiduciary’s Exercise Of Proxy Voting And Other Shareholder Rights Is A Function Subject To ERISA’s Stringent Fiduciary Rules.

AARP supports the Department’s proposal that the fiduciaries must exercise their general prudence, loyalty and other fiduciary obligations as to proxy voting and the exercise of shareholder rights. We agree that the exercise of proxy voting and other shareholder rights is a fiduciary function, as it is one method by which to protect the interests of plan participants.

We support the DOL’s longstanding view that proxies generally should be voted, unless a fiduciary determines the costs would outweigh the benefits. This caveat is consistent with the fiduciary’s responsibility of ensuring that costs of administering the plan are reasonable.²⁹ We agree with the Department that proxy voting policies potentially can help fiduciaries reduce costs and compliance burdens.

As AARP has previously stated, ERISA’s fiduciary obligations inform all of a fiduciary’s actions. As a result, any monitoring or documentation obligation for the exercise of shareholder rights must meet the same requirements as other fiduciary actions.

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²⁹ ERISA §404(a)(1)(A), 29 U.S.C. §1104(a)(1)(A).

We appreciate the Department's interest and commitment to ensuring that participants and beneficiaries are protected. We are willing to provide any further assistance as needed.

If you have any questions, please feel free to contact Michele Varnhagen of our Government Affairs office at MVarnhagen@aarp.org or 202-434-3829.

Sincerely,

A handwritten signature in black ink, appearing to read "David Certner", with a long horizontal flourish extending to the right.

David Certner
Legislative Counsel and Legislative Policy Director
Government Affairs

cc: Timothy D. Hauser
Deputy Assistant Secretary

Joe Canary
Office Director
Office of Regulations and Interpretations