December 13, 2021

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

Re: Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights [RIN 1210–AC03]

Submitted via www.regulations.gov

Dear Mr. Khawar:

I am pleased to provide these comments on the proposed rule "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights."[1]

The Proposed Rule is a Sophisticated Attempt to Circumvent the ERISA Statute

The proposed rule contains both positive and highly negative provisions. At its core, however, it is an attempt to weaken ERISA's protection of plan beneficiaries[2] to achieve political objectives that are unrelated to the purposes of ERISA in response to political pressure from the White House.[3] To the extent that it is successful in achieving its objectives, the proposed rule will result in lower returns and less retirement income for plan beneficiaries. The DOL does not have the discretion to substitute its political judgement or that of the White House for that of Congress as expressed very explicitly by statute in ERISA.

The proposed rule is an invitation to ERISA fiduciaries to pursue their political or social goals at the expense of plan beneficiaries. Read honestly, the proposed rule would serve no other purpose. In effect, if the proposed rule were finalized, the DOL would be saying to plan fiduciaries "You must act in the interest of plan beneficiaries but if you pursue a progressive ESG objective at the expense of plan beneficiaries, we won't call you on it and, by the way, we have eliminated the means of actually enforcing the rules requiring that you act in plan beneficiaries' interests."

The proposed rule should be withdrawn.

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[1] "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights," Proposed Rule, *Federal Register*, Vol. 86, No. 196, October 14, 2021, pp. 57272-57304 [RIN 1210–AC03].
[2] Employee Retirement Income Security Act of 1974 (29 U.S. Code, Chapter 18, §1001 et seq,).
[3] See, for example, Executive Order 14030 May 20, 2021, entitled ''Executive Order on Climate-Related Financial Risk,'' published at *Federal Register*, Vol. 86, No. 99, May 25, 2021, pp. 27967-27971 cited in the rulemaking. Obviously, however, less public political pressure has also been brought to bear.

Fiduciaries are obligated by law to act in the interest of plan beneficiaries and are not permitted to take actions that reduce the return to beneficiaries to further a social or political objective of the fiduciary. Specifically, ERISA at 29 U.S. Code §1104(a)[4] requires that "a fiduciary shall discharge his duties with respect to a plan ***solely*** in the interest of the participants and beneficiaries and (A) for the ***exclusive*** purpose of (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan." (emphasis added).

To its credit, the proposed rule acknowledges this fact at subsection (c)(1).

> (c) Investment loyalty duties. (1) 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 investment return or take on additional investment risk to promote benefits or goals unrelated to interests of the participants and beneficiaries in their retirement income or financial benefits under the plan.[5]

This said, the remainder of the proposed rule is an attempt to undermine this long-standing statutory principle and this subsection of the proposed rule.

Most notably, the proposed rule includes this provision:

> (b)(4) A prudent fiduciary may consider any factor in the evaluation of an investment or investment course of action that, depending on the facts and circumstances, is material to the risk return analysis, which might include, for example:
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>> (i) Climate change-related factors, such as a corporation's exposure to the real and potential economic effects of climate change including exposure to the physical and transitional risks of climate change and the positive or negative effect of Government regulations and policies to mitigate climate change;
>> (ii) Governance factors, such as those involving board composition, executive compensation, and transparency and accountability in corporate decisionmaking, as well as a corporation's avoidance of criminal liability and compliance with labor, employment, environmental, tax, and other applicable laws and regulations; and
>> (iii) Workforce practices, including the corporation's progress on workforce diversity, inclusion, and other drivers of employee hiring, promotion, and retention; its investment in training to develop its workforce's skill; equal employment opportunity; and labor relations.[6]

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[4] Section 404 of ERISA.
[5] Proposed Rule §2550.404a–1(c)(1), *Federal Register*, Vol. 86, No. 196, October 14, 2021, p. 57303.
[6] Proposed Rule §2550.404a–1(b)(4), *Federal Register*, Vol. 86, No. 196, October 14, 2021, pp. 57302-57303.

Had the proposed rule stopped with the first clause, to wit, "A prudent fiduciary may consider any factor in the evaluation of an investment or investment course of action that, depending on the facts and circumstances, is material to the risk return analysis," then it would have been true to the statutory language in ERISA. But instead, the "examples" of materiality provided include only progressive ESG priorities. As discussed below, the empirical economics literature shows that these priorities have little to no impact on financial returns.

These provisions (subparagraphs (i) through (iii)) are really nothing more than an indication to ERISA fiduciaries that they will suffer little or no consequences from the DOL, and that DOL enforcement actions will not be forthcoming, if they choose to pursue progressive ESG social and political objectives at the expense of plan beneficiaries *provided that* they steadfastly hold to the fiction that the reason that they did so was a concern about the ESG factors' *materiality*. The true purpose of this provision is obvious given that the DOL only "happened" to choose examples of potentially "material" factors motivated by progressive political and social objectives rather than the many thousands of other examples of materiality factors that could have been provided. Admittedly, given *Chevron*[7] and *Auer*[8] deference, these provisions may well afford politicized plan fiduciaries some legal cover. On the other hand, an objective court should see through this subterfuge and should seek to actually enforce the clear Congressional intent to protect plan beneficiaries by invalidating this transparent, although sophisticated, attempt to circumvent the law.

Another example of the invitation to plan fiduciaries to pursue ESG factors at the expense of beneficiaries' retirement income is this provision in proposed section (c)(3):

> (3) If, after the analysis in paragraph (c)(2) of this section, a fiduciary prudently concludes that competing investments, or competing investment courses of action, equally serve the financial interests of the plan over the appropriate time horizon, the fiduciary is not prohibited from selecting the investment, or investment course of action, based on collateral benefits other than investment returns. … A fiduciary may not, however, accept expected reduced returns or greater risks to secure such additional benefits.

The final sentence of the paragraph is, of course, an accurate description of the statutory requirements under ERISA. The 'collateral benefits' language is the invitation to ignore the final sentence.

In actual practice, there will be very, very few actual "ties" that can be broken by non-financial considerations. Any normal financial methodology is going to give a series of ranked order choices, not "ties" where competing investments have precisely the same projected return. Moreover, the *existing* regulation actually contains tie-breaking language. It just requires that the tie and the tie-breaking mechanism *be documented*. See 29 CFR §2550.404a-1(c)(2):

> (c)(2) Notwithstanding the requirements of paragraph (c)(1) of this section, when choosing between or among investment alternatives that the plan fiduciary is able

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[7] *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).
[8] *Auer v. Robbins*, 519 U.S. 452 (1997).

> to distinguish on the basis niary factors alone, the fiduciary may use non-pecuniary factors as the deciding factor in the investment decision provided that the fiduciary documents:
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> > (i) Why pecuniary factors were not sufficient to select the investment or investment course of action;
> > (ii) How the selected investment compares to the alternative investments with regard to the factors listed in paragraphs (b)(2)(ii)(A) through (C) of this section; and
> > (iii) How the chosen non-pecuniary factor or factors are consistent with the interests of participants and beneficiaries in their retirement income or financial benefits under the plan.

That the DOL is using one of its first rulemakings to address this very rare instance regarding how to resolve a tie is simply not credible. The rule is in fact an invitation to circumvent ERISA in response to White House and other political pressures. That the proposed rule eliminates the documentation requirements contained in the existing rule is also a clear indication that what is really going on here is NOT a tie-breaking mechanism. What is really going on is that the DOL is inviting fiduciaries to politicize their investment decisions and telling them that this will be okay in practice notwithstanding the ERISA statutory requirement. The proposed rule would make it perfectly okay for politicized fiduciaries to not leave a paper trail[9] so that plan beneficiaries, or a DOL that is willing to enforce ERISA laws as written, will be unable to establish the methodology employed to make investment decisions.

If ESG Were in Plan Beneficiaries' Interest, then No Change in the Rule is Required

If pursuing progressive ESG social and political goals *actually* were in investor or plan participant financial interest, then no action would be required by the DOL. The relevant ESG factors would be material and such investments would be the best means of providing plan benefits to plan beneficiaries under the existing, and long-standing, principles of ERISA law. Period. Full stop. The problem, of course, as explained below, is that this is not true. Special legal cover is needed so that plan fiduciaries can pursue ESG goals at the expense of plan beneficiaries.

ESG is Not in Plan Beneficiaries' Interest Notwithstanding the Multiple Claims to the Contrary

<u>Racial, Ethnic, Sex and Sexual Orientation Discrimination does not Promote Higher Plan Beneficiary Returns</u>

The Securities and Exchange Commission was recently presented with the question of whether Nasdaq can require its listed companies to impose racial, ethnic, sex and sexual orientation

[9] Under the current rules, the documentation requirements impose a very modest burden because actual ties are so rare. They do, however, pose a significant barrier to ERISA fiduciaries seeking to make investments for political purposes because subterfuge can be effectively policed by the DOL.

requirements regarding the board composition of its listed companies. Nasdaq falsely asserted that this would improve shareholder returns. It has not and will not.[10]

The SEC, to its credit, acknowledged this fact. It stated that "Taken together, studies of the effects of board diversity are generally inconclusive, and suggest that the effects of even mandated changes remain the subject of reasonable debate."[11] The Commission then went on to approve the rule anyway but at least the agency had the integrity to not misrepresent the economics literature as Nasdaq blatantly did in its submission to the SEC.

It should, of course, come as no surprise that the race, ethnicity, sex or sexual orientation of board members have no impact on firm financial since these factors have no bearing on the competence or relevant experience of the person involved. To hold otherwise is to accept a racial, ethnic and sexual determinism that is fundamentally at odds with the equal protection provisions of our constitution and the principles underlying the Civil Right Act.[12]

Climate Change, or the E in ESG

The economic justification for climate change disclosure mandates or climate change socially responsible investing (aka 'collateral benefits' in the proposed rule) is that they are designed to address a negative externality. An externality is (1) a cost that is imposed on (negative externality) or (2) a benefit accorded to (positive externality) someone that is not a party to a transaction or not engaged in an action. There are countless positive and negative externalities all around us. Air pollution is a typical example of a negative externality.

There are many ways to address negative externalities. Improved property rights,[13] tort law,[14] regulation,[15] or a tax equal to the cost involuntarily imposed by the economic actor creating the

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[10] See, for example, comment letter from David R. Burton, Heritage Foundation to the SEC, January 4, 2021 https://www.sec.gov/comments/sr-nasdaq-2020-081/srnasdaq2020081-8204282-227462.pdf; comment letter from the Alliance for Fair Board Recruitment to the SEC, April 6, 2021 https://www.sec.gov/comments/sr-nasdaq-2020-081/srnasdaq2020081-8639478-230941.pdf; Jesse M. Fried, Will Nasdaq's Diversity Rule Harm Investors?, European Corporate Governance Institute, Law Working Paper No. 579/2021, March 31, 2021 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3812642; Jonathan Klick, "Review of the Literature on Diversity on Corporate Boards,' American Enterprise Institute, April 2021 https://www.aei.org/wp-content/uploads/2021/04/Review-of-the-Literature-on-Diversity-on-Corporate-Boards.pdf?x91208; comment letter from Publius Oeconomicis to the SEC, December 28, 2020 https://www.sec.gov/comments/sr-nasdaq-2020-081/srnasdaq2020081-8186013-227180.pdf.

[11] "Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Order Approving Proposed Rule Changes, as Modified by Amendments No. 1, To Adopt Listing Rules Related to Board Diversity and To Offer Certain Listed Companies Access to a Complimentary Board Recruiting Service," Securities and Exchange Commission, *Federal Register*, Vol. 86, No. 153, August 12, 2021, p. 44432 https://www.govinfo.gov/content/pkg/FR-2021-08-12/pdf/2021-17179.pdf. See also p. 44433.

[12] David R. Burton, "Nasdaq's Proposed Board-Diversity Rule Is Immoral and Has No Basis in Economics," Heritage Foundation Backgrounder No. 3591, March 9, 2021 https://www.heritage.org/sites/default/files/2021-03/BG3591_0.pdf.

[13] In the case of air and water that are usually unowned resources, this is problematic. In other cases, this can be the solution, although transactions costs can impede a private solution. See Ronald H. Coase, "The Problem of Social Cost," *Journal of Law and Economics*, Vol. 3, October, 1960, pp. 1–44.

[14] The common law of nuisance and various more modern environmental torts.

[15] Most notably by the Environmental Protection Agency and state analogs.

externality on those "external" to the transaction.[16] A tax subsidy for politically favored interests with strong lobbies would be fairly far down the list of efficacious means of addressing the problem of negative externalities but nonetheless there are many provisions in the Internal Revenue Code with this purpose. To achieve the desired effect, the policy designed to address the externality must be calibrated to accurately internalize the actual cost of the externality. This requires estimating the costs imposed by the externality and imposing costs in an equal and off-setting amount on the economic actor in question. Detailed scientific, cost and market information must be obtained to get this even close to right.

Trying to achieve this result through mandated disclosures by issuers is comparable to trying to score in basketball by bouncing the ball off the floor and then the backboard. It is theoretically possible, but there is a vanishingly small chance that it will achieve the desired result. And any team that tried that on a regular basis would lose.

Similarly, ERISA is not the place to do environmental regulation.

I am no climate science expert. Nor, I suspect, is anyone at the Department of Labor since climate science is way outside of the DOL's lane. I do know a thing or two about modeling in an economics context. Models are typically highly dependent on a few relationships specified in their equations and parameters. A small number of assumptions about relationships and parameters drive results. For example, a model examining the impact of proposed tax policy might adopt a neoclassical view where the impact of the proposed tax changes on the user cost of capital and labor response are central (as specified in the equations) and the empirical parameters (as specified in the elasticities) governing investment and labor are key.[17] Seemingly small adjustments to elasticities (even though within the bounds established in the empirical literature) result is significantly different results. A Keynesian "macroeconomic" approach focusing on aggregate demand would yield dramatically different results, operate on different principles and lead to different policy recommendations. And so on.

Climate modeling is, in principle, no different. A small number of equations and empirical parameters drive results. Even the conventional governmental source -- the Intergovernmental Panel on Climate Change – shows massive variations in projections and shows the wide divergence in the ability of models to account for past warming[18] and the degree of warming that is anthropogenic.[19] The worst-case concentration pathway, for example, assumes unlikely

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[16] This is commonly known as a Pigouvian tax. See Arthur Cecil Pigou, *The Economics of Welfare* (1920 and various later editions); "Pigouvian Taxes," *The Economist*, August 19, 2017 https://www.economist.com/news/economics-brief/21726709-what-do-when-interests-individuals-and-society-do-not-coincide-fourth.

[17] Parker Sheppard and David Burton, "How the GOP Tax Bill Will Affect the Economy," *Daily Signal*, November 17, 2017 https://www.dailysignal.com/2017/11/17/gop-tax-bill-will-affect-economy/. In this case, we used the Hall-Jorgenson user cost of capital equation, the Cobb-Douglas production function and conventional price theoretic labor market modeling.

[18] See, for instance, Byron A. Steinman, Michael E. Mann and Sonya K. Miller, "Atlantic and Pacific Multidecadal Oscillations and Northern Hemisphere Temperatures," *Science*, February 27, 2015, Vol. 347, Issue 6225, pp 988-991, https://science.sciencemag.org/content/347/6225/988#aff-1 and Joseph Majkut, "Climbing the Staircase of Global Warming," Niskanen Center, July 27, 2016, https://www.niskanencenter.org/climbing-staircase-global-warming/.

[19] *Climate Change 2014 Synthesis Report*, Intergovernmental Panel on Climate Change https://www.ipcc.ch/site/assets/uploads/2018/02/SYR_AR5_FINAL_full.pdf See, for example, "The Representative

projections of coal use, high population growth, low economic growth and technological progress.[20] Using the worst-case scenario of these emissions concentration pathways as the business-as-usual scenario will mislead the private sector, policymakers, and regulators on the estimated climate impacts and costs.[21]

Once you broaden your reading to include those that do not have a financial or political interest in climate change alarmism, it becomes clear that the variance and uncertainty in climate modeling is even higher than the IPCC report indicates.[22] It is clear that various models yield dramatically different results. Explaining the details is beyond the scope of this letter and my current competence. It is also beyond the ability of the Employee Benefits Security Administration. EBSA will be unable to actually assess the veracity of fiduciaries' claims that they are accurately assessing the materiality and investment decisions made on the basis of climate change considerations. Thus, it will have to simply accept assertions by politically motivated fiduciaries that their assessment is legitimate and the language in the rule will make this acceptable.

The Ambiguity of the Economics of Climate Change

Any estimate of the economic impact of climate change will have to rely on the highly uncertain and divergent climate model results discussed above. In addition to this high degree of uncertainty will be added an entirely new family of economic ambiguity and uncertainty. Moreover, any economic estimate of the impact of climate change will also have to choose a discount rate to arrive at the present discounted value of future costs and benefits[23] of climate change and to estimate the future costs and benefits of various regulatory or private initiatives. The choice of discount rate is controversial and important. Estimates will need to be made of the

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Concentration Pathways," (p. 57); "Box 2.3, Models and Methods for Estimating Climate Change Risks, Vulnerability and Impacts," (pp. 58-59); "Table 2.1, Projected Change in Global Mean Surface Temperature and Global Mean Sea Level Rise for the Mid- and Late 21st Century, Relative to the 1986–2005 Period," (p. 60); "Cumulative Total Anthropogenic CO2 Emissions from 1870 (GtCO2)," (p. 63); "Table 2.2, "Cumulative Carbon Dioxide (CO2) Emission Consistent with Limiting Warming to Less than Stated Temperature Limits at Different Levels of Probability, Based on Different Lines of Evidence," (p. 64). The updated sixth version of the Synthesis Report is due for release in 2022.

[20] Justin Ritchie and Hadi Dowlatabadi, "Why Do Climate Change Scenarios Return to Coal?" *Energy*, December 2017, Vol. 140, Part 1, pp 1276-1291, https://www.sciencedirect.com/science/article/abs/pii/S0360544217314597.

[21] Pielke, Roger and Ritchie, Justin, "Systemic Misuse of Scenarios in Climate Research and Assessment," April 21, 2020, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3581777.

[22] Steven E. Koonin, *Unsettled: What Climate Science Tells Us, What It Doesn't, and Why It Matters*, Chapter 4, "Many Muddled Models," (Dallas, TX: BenBella Books, 2021); Bjorn Lomborg, *False Alarm: How Climate Change Panic Costs Us Trillions, Hurts the Poor, and Fails to Fix the Planet*, (New York: Basic Books, 2020); Pat Michaels and Chip Knappenberger, *Lukewarming: The New Climate Science that Changes Everything*, (Washington: Cato Institute, 2016); Benjamin Zycher, Resident Scholar, American Enterprise Institute, Statement before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Hearing on the "21st Century Economy: Protecting the Financial System from Risks Associated with Climate Change" March 18, 2021 https://www.banking.senate.gov/imo/media/doc/Zycher%20Testimony%203-18-21.pdf; Kevin Dayaratna, Ross McKitrick and David Kreutzer, "Empirically Constrained Climate Sensitivity and the Social Cost of Carbon," *Climate Change Economics*, Vol. 8, No. 2, 2017, pp. 1-12 https://econpapers.repec.org/article/wsiccexxx/v_3a08_3ay_3a2017_3ai_3a02_3an_3as2010007817500063.htm.

[23] There are definitely some benefits. For example, large portions of Northern areas such as Canada, Russia, Scandinavia and Alaska would presumably become suitable for agriculture.

cost of various aspects of climate change (sea level rises, the impact on agriculture, etc). Estimates will need to be made of the cost of various remediation techniques. Guesses will need to be made about the rate of technological change. Guesses will need to be made about the regulatory, tax and other responses of a myriad of governments. Estimates will need to be made using conventional economic techniques regarding the economic impact of those changes which, in turn, will reflect a wide variety of techniques and in many cases a thin or non-existent empirical literature. Guesses will need to be made of market responses to all of these changes since market participants will not stand idly by and do nothing as markets and the regulatory environment change.

Then, after making decisions regarding all of these extraordinarily complex, ambiguous and uncertain issues, fiduciaries will then need to assess, on some undetermined basis, the likely impact of climate change on their specific business years into the future – a business that may by then bear little resemblance to the issuer's existing business. Then, the DOL will need to assess fiduciaries' actions based on this speculative house of cards.

Conclusion

To the extent it plows new ground, the proposed rule is inconsistent with the statutory charge under ERISA that "a fiduciary shall discharge his duties with respect to a plan ***solely*** in the interest of the participants and beneficiaries and (A) for the ***exclusive*** purpose of (i) providing benefits to participants and their beneficiaries." The proposed rule is an invitation to ERISA fiduciaries to pursue their political or social goals at the expense of plan beneficiaries. It is a sophisticated attempt to circumvent ERISA. It should be withdrawn.

Sincerely,

David R. Burton
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