



Comment Paper on Rule Proposed by the Employee Benefits Security Administration, U.S. Department of Labor: “Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights,” October 14, 2021

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The Employee Benefits Security Administration of the U.S. Department of Labor has proposed a revision to the “Financial Factors in Selecting Plan Investments” rule finalized on November 13, 2020. This revision is inconsistent with the goals and requirements of the Employee Retirement Income Security Act of 1974, as it would weaken the requirement for fund fiduciaries to constrain their investment choices only to the expected risk and return objectives serving the financial interests of fund beneficiaries. By allowing the introduction of Environmental, Social, and Governance and other non-pecuniary objectives and considerations, the proposed rule inexorably would politicize investment decisions to some extent, impose artificial constraints on investment options, and thus reduce expected returns and/or increase risks. The resulting misallocation of capital would inflict adverse effects upon the economy writ large. This proposed rule therefore is perverse and should not be finalized. Moreover, because this proposed rule in effect would rewrite ERISA, any such revision of the law must be enacted by the Congress. Accordingly, the proposed rule is inconsistent with the structure and constraints imposed by the constitution, and thus would erode our constitutional institutions.

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This comment paper responds to a request from the Employee Benefits Security Administration, U.S. Department of Labor, for comments on its rule proposed on October 14, 2021, “Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights” (hereinafter the “Prudence and Loyalty” rule).¹ The proposed rule would be a revision to the “Financial Factors in Selecting Plan Investments” final rule published on November 13, 2020 (hereinafter the “Financial Factors” rule).² In summary, the rule now proposed would allow the introduction of “Environmental, Social, and Governance” (ESG) and other non-pecuniary factors to influence the investment choices made by fund managers with fiduciary responsibilities to fund participants as defined in the Employee Retirement Income Security Act of 1974 (ERISA).³

This proposed rule should not be finalized in its current form, because it necessarily would reduce expected returns and increase the risks of investment choices made on behalf of fund beneficiaries protected by ERISA. Instead the final Financial Factors rule published on November 13, 2020 should be preserved. Moreover, this proposed rule in effect would rewrite ERISA so as to allow for the introduction of investment criteria inconsistent with the fiduciary interests of fund participants; any such revision of the law must be enacted by the Congress. Accordingly, the proposed rule is inconsistent with the structure and constraints imposed by the constitution, and thus would erode our constitutional institutions. This comment paper is organized as follows:

Summary

- I. Introduction.
- II. Risk/Return and Other Benefits of the Financial Factors Rule.
- III. The “Tie Breaker” Model of Non-Pecuniary Investment Criteria is Sophistry.
- IV. Any Change in ERISA Requirements Must Be Enacted by the Congress.
- V. Conclusions.

Summary

The Prudence and Loyalty rule proposed by the Department of Labor cannot be made consistent with ERISA and the judicial decisions interpreting it, and thus with the fiduciary interests of participants in funds governed by ERISA, because the non-pecuniary factors proposed as investment objectives for such funds are immune to rigorous definition. They are, therefore, subjective, and thus inexorably political, inviting fund managers to substitute their political preferences to some degree in place of the fiduciary interests of plan participants as protected by ERISA. The “tie breaker” or “otherwise indistinguishable” model of non-pecuniary investment criteria cannot work as envisioned because analysis of future investment outcomes by definition is afflicted with important uncertainties, the resolution of which requires choices among alternative assumptions that cannot be quantified rigorously. They too are subjective and thus inexorably political.

¹ See <https://www.federalregister.gov/documents/2021/10/14/2021-22263/prudence-and-loyalty-in-selecting-plan-investments-and-exercising-shareholder-rights>.

² See <https://www.federalregister.gov/documents/2020/11/13/2020-24515/financial-factors-in-selecting-plan-investments>.

³ On ERISA, see <https://www.dol.gov/general/topic/retirement/erisa>. See also Eugene Scalia, “Retirees’ Security Trumps Other Social Goals,” *Wall Street Journal*, June 23, 2020, at <https://www.wsj.com/articles/retirees-security-trumps-other-social-goals-11592953329>.

A substantial body of evidence demonstrates that the insertion of non-pecuniary investment criteria in the management of pension and other such funds imposes a substantial penalty over time in terms of realized returns. This is not surprising: Such non-pecuniary criteria represent artificial constraints on investment choices and/or biases that interfere with the allocation of resources within a portfolio consistent with the various correlations and other investment characteristics that determine the financial outcomes yielded by fund performance. The data show that this is particularly the case for biases against investments in fossil-fuel sectors.

It is essential that the Department of Labor preserve the Financial Factors rule by not finalizing the Prudence and Loyalty rule. This is particularly important given the growing attempts, by many market participants and by those in a position to pressure firms, to use the resources of funds governed by ERISA to pursue goals inconsistent with value maximization for plan participants. Such goals inevitably must be politicized — no other outcome is possible — a deeply perverse set of constraints that even in principle cannot yield maximum (or the most beneficial) return/risk outcomes for current and future retirees protected by ERISA. Value maximization will serve their interests, and by allocating capital toward economic returns higher rather than lower also will serve to create an economy larger rather than smaller, an outcome beneficial for all consumers. Moreover, the Prudence and Loyalty proposed rule in effect would rewrite ERISA; any such revision of the law must be enacted by the Congress. Accordingly, the proposed rule is inconsistent with the structure and constraints imposed by the constitution, and thus would erode our constitutional institutions.

I. Introduction

ERISA Title I imposes minimum standards constraining the management of employee benefit plans in the private sector, including rules defining the fiduciary responsibilities of fund managers. ERISA sections 403(c) and 404(a) require fiduciaries to act solely in the interests of the respective plans participants and beneficiaries, and for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable expenses of plan administration.

The courts have interpreted the exclusive-purpose rule of ERISA section 404(a)(1)(A) to require fiduciaries to act with “complete and undivided loyalty to the beneficiaries,” observing that their decisions must “be made with an eye single to the interests of the participants and beneficiaries.”⁴ The Supreme Court in 2014 held unanimously in the context of ERISA retirement plans that such interests must be understood to refer to “financial” rather than “nonpecuniary” benefits.⁵ The Prudence and Loyalty proposed rule states explicitly that

The Department has a longstanding position that ERISA fiduciaries may not sacrifice investment returns or assume greater investment risks as a means of promoting collateral social policy goals. These proscriptions flow directly from ERISA's stringent standards of prudence and loyalty under section

⁴ For the legal references, see the Prudence and Loyalty proposed rule at p. 57304, at <https://www.federalregister.gov/documents/2021/10/14/2021-22263/prudence-and-loyalty-in-selecting-plan-investments-and-exercising-shareholder-rights>.

⁵ *Ibid.*

404(a) of the statute. The Department has a similarly longstanding position that the fiduciary act of managing plan assets that involve shares of corporate stock includes making decisions about voting proxies and exercising shareholder rights. Over the years the Department repeatedly has issued non-regulatory guidance to assist plan fiduciaries in understanding their obligations under ERISA in these areas.⁶

Note that the Financial Factors rule stated:

The Department has been asked periodically over the last 30 years to consider the application of these principles to pension plan investments selected because of the non-pecuniary benefits they may further, such as those relating to environmental, social, and corporate governance considerations. Various terms have been used to describe this and related investment behaviors, such as socially responsible investing, sustainable and responsible investing, environmental, social, and corporate governance (ESG) investing, impact investing, and economically targeted investing. The terms do not have a uniform meaning and the terminology is evolving.⁷

Precisely because the “terms do not have a uniform meaning and the terminology is evolving,” the Prudence and Loyalty proposed rule does not attempt to quantify or even to define the “non-pecuniary benefits” to be “further[ed],” and the identities of the attendant beneficiaries of those “non-pecuniary benefits” similarly are not delineated. Again: ERISA is clear that the only beneficiaries relevant to the fiduciary responsibilities of fund managers are the fund participants.

Let us note clearly that such (ambiguous) terms as “socially responsible,” “sustainable and responsible,” “environmental, social, and corporate governance (ESG),” “impact,” and “economically targeted” as descriptions of investment objectives or constraints are highly elastic, even apart from the conflicts among them that given definitions might engender, and apart from the inconsistencies between given definitions and the fiduciary responsibility of fund managers to focus exclusively upon a maximization of the financial wellbeing of fund participants. This unavoidable elasticity in definitions means that the inclusion of such “non-pecuniary” factors in investment decisions inevitably would be politicized, an outcome that cannot serve the pecuniary interests of fund participants as defined in ERISA. The Financial Factors rule recognized explicitly that

There is no consensus about what constitutes a genuine “ESG” investment, and ESG rating systems are often vague and inconsistent, despite featuring prominently in marketing efforts. The use of terms such as ESG, impact investing, sustainability, and non-financial performance metrics, among others, encompass a wide variety of considerations without a common nexus and can take on different meanings to different people. In part, the confusion stems from the fact that, from its beginning, the ESG investing movement has had multiple goals, both pecuniary and non-pecuniary. Moreover, ESG funds often come with higher fees, because additional investigation and

⁶ See the proposed rule at p. 57273.

⁷ See the Financial Factors rule at p. 72846.

monitoring are necessary to assess an investment from an ESG perspective.⁸

The characterization of the inconsistencies among various non-pecuniary goals as “confusion” itself is confused, in that the pressures to supplement pecuniary considerations with non-pecuniary goals in fund investment decisions are an obvious attempt to use fund monetary resources otherwise constrained by ERISA requirements to pursue political objectives that may or may not be favored by any given fund participant. An obvious example is a “sustainability” objective the most obvious manifestation of which is an investment bias against fossil fuels as part of an effort somehow to reduce global emissions of greenhouse gases.⁹

Note that it is more difficult for participants in pension funds and other such plans governed by ERISA to exit plans pursuing non-pecuniary objectives with which they disagree, or for which the pursuit of such non-pecuniary objectives imposes a financial penalty that a given participant finds excessive, relative to the case for ordinary participants in investment funds that can be bought or sold in open financial markets.

Precisely because the objectives now often proposed for plans governed by ERISA are separate from strict risk-return considerations, they cannot be insulated from political influences — such influences are central to the justifications typically offered for them — and it is obvious that political considerations are inconsistent with the fiduciary requirements of ERISA. It is those risk/return and other benefits of the Financial Factors rule to which I now turn.

II. Risk/Return and Other Benefits of the Financial Factors Rule

The Financial Factors rule finalized by the Department of Labor last November was timely and needed, and particularly important given the growing trend among fund managers governed by ERISA to incorporate ESG considerations in investment decisions. Such considerations must be heavily political, in particular because the choices among alternative ESG goals inevitably are arbitrary, and because the inevitable conflicts among them, and with the traditional and appropriate goal of value maximization, allow for no straightforward constraint on the ability of fund managers to use ESG factors to advance their own priorities. Thus does ESG investing conflict sharply with the interests of current and future retirees. Accordingly, investment decisions influenced by ESG considerations must carry with them serious adverse implications for the investment returns earned by current and future pensioners, that is, for their pecuniary interests.

The central importance of the Financial Factors rule was captured well in section B summarizing the rule’s provisions:

Paragraph (c)(1) directly provides that a fiduciary's evaluation of an investment must be focused only on pecuniary factors. The paragraph explains that it is unlawful for a fiduciary to sacrifice return or accept

⁸ See the Financial Factors rule at pp. 72847-72848.

⁹ The perversities of such policy proposals are discussed in Benjamin Zycher, “The Case for Climate-Change Realism,” *National Affairs*, Fall 2021 (no. 49), at <https://www.nationalaffairs.com/publications/detail/the-case-for-climate-change-realism>.

additional risk to promote a public policy, political, or any other non-pecuniary goal.

The rule went on to note that:

The Department is concerned that the growing emphasis on ESG investing, and other non-pecuniary factors, may be prompting ERISA plan fiduciaries to make investment decisions for purposes distinct from their responsibility to provide benefits to participants and beneficiaries and defraying reasonable plan administration expenses. The Department is also concerned that some investment products may be marketed to ERISA fiduciaries on the basis of purported benefits and goals unrelated to financial performance.

The ongoing drive for the inclusion of ESG factors in investment decisions by funds unquestionably is dominated by the purported evaluation of climate “risks,” a concept that in the context of this proposed rule comprises two conceptually distinct imperatives:

- The incorporation in investment decisions of a bias against investment in firms and industries that yield disproportionate emissions of greenhouse gases (GHG), whether directly or indirectly.
- The evaluation and disclosure of financial risks posed to given firms by future anthropogenic climate change, assumed by the proponents of ESG investment constraints to be predictable within small margins of variation out to, say, the year 2100.

The Anti-GHG Bias. The issue to be addressed here is whether either of those imperatives is consistent with the fiduciary interests of current and future beneficiaries of pension and retirement funds governed under ERISA. With respect to the investment bias against the fossil-fuel industry and other such direct or indirect sources of disproportionate GHG emissions, the central reality to be recognized is straightforward: The imposition of an artificial constraint upon investment choices by definition cannot result in systematically improved financial returns to pension and retirement funds relative to a set of investment options not subject to such constraints. This is not merely an empirical observation; it is one driven by the eternal reality that a reduction in the investment options considered acceptable cannot improve overall investment performance.

That reality is clear in the evidence. Consider, for example, the effects of divestment from fossil-fuel producers. University of Chicago Law School emeritus professor Daniel R. Fischel found in a study that:

[Of the] 10 major industry sectors in the U.S. equity markets, energy has the lowest correlation with all others, followed by utilities---meaning that companies in these sectors provide the largest potential diversification benefit to investors, and that divestment would reduce returns substantially.¹⁰

A fact sheet released with the Fischel study notes that:

¹⁰ http://divestmentfacts.com/pdf/Fischel_Report.pdf.

In particular, Professor Fischel’s study tracks the performance of two hypothetical investment portfolios over a 50-year period: one that included energy-related stocks, and another that did not. The portfolio which included energy stocks generated average annual returns 0.7 percentage points greater than the portfolio that excluded them on an absolute basis and 0.5 percentage points per year higher on a risk adjusted basis. In other words, the “divested” portfolio lost roughly 50-70 basis points each and every year over the prior 50-years. Professor Fischel’s study also found that ongoing management fees are likely to be as much as three times higher for a portfolio divested of fossil fuel stocks.¹¹

There has been extensive research on the question of the returns of ESG portfolios vs. broad index portfolios. For example, Adler and Kirtzman concluded in the *Journal of Portfolio Management* that “the cost of socially responsible investing is substantial for even moderately skilled investors.”¹² A comparison published by the research firm MSCI found that \$100 invested in the MSCI KLD 400 Social Index, a popular ESG index, grew to \$338.08 for the 15 years ending Nov. 30, 2018. By comparison, \$100 invested in the MSCI USA Investable Market Index, comprising approximately 3,000 stocks across all market capitalizations (a proxy for the entire U.S. market), grew to \$369.84 – or 9.4% more.¹³ An analysis by Wayne Winegarden of the Pacific Research Institute concludes that:

Of the 18 ESG funds examined that had a full 10-year track record, a \$10,000 ESG portfolio (equally divided across the funds including the impact from management fees) would be 43.9 percent smaller after 10-years compared to a \$10,000 investment into an S&P 500 index fund. Further, only 1 of the 18 funds was able to exceed the earnings of an S&P 500 benchmark investment over a 5-year investment horizon, and only 2 of the 18 funds were able to beat the S&P 500 benchmark over a 10-year investment horizon.¹⁴

Additional analysis found that one of the oldest and largest ESG Exchange Traded Funds (ETF) yielded returns over 10 years thirty-seven basis points lower than the S&P 500 index.¹⁵ Another analysis shows that for the five-year period ending last May 15, Blackrock’s S&P 500 Growth ETF yielded average annual returns 10 basis points higher than those yielded by the Blackrock Clean Energy ETF.¹⁶

The adverse effects of ESG investing are evident. Trustees of public-pension plans, for example, have ignored the explicit advice of financial advisors retained by the plans themselves so as to adopt ESG policies that reduce returns for millions of investors. In May 2017, for example, some members of the board of the \$25 billion San Francisco Employees Retirement System

¹¹ <https://www.compasslexecon.com/compass-lexecon-releases-fischel-study-on-effect-of-fossil-fuel-divestment-proposals-on-university-endowments/>.

¹² <http://jpm.ijournals.com/content/35/1/52>.

¹³ <https://www.msci.com/documents/10199/904492e6-527e-4d64-9904-c710bf1533c6>.

¹⁴ https://www.pacificresearch.org/wp-content/uploads/2019/05/ESG_Funds_F_web.pdf.

¹⁵ <https://www.bloomberg.com/opinion/articles/2020-01-27/esg-etfs-your-socially-conscious-fund-probably-has-some-holes>.

¹⁶ <https://www.barrons.com/articles/blackrock-is-playing-politics-with-public-pensions-51590661589>.

(SFERS) proposed divesting its portfolio of holdings of the 200 largest fossil fuel companies that comprise the Carbon Underground 200 stocks.¹⁷ The board then asked its general investment consultant, NEPC Investment Consulting, to analyze the consequences of such a divestment. SFERS staff examined NEPC's work and stated:

Retirement staff concurs with NEPC's conclusion that divestment from Carbon Underground 200 fossil fuel companies will materially reduce the potential risk-adjusted returns from the SFERS public markets portfolio.

Accordingly, the staff recommended against divestment.

In 2016, the California Public Employees Retirement System (CalPERS), the largest public-pension system in the U.S. with about 2 million members, similarly examined the question of whether to continue a policy of blacklisting tobacco companies. Its financial advisor, Wilshire Associates, estimated that the policy had cost the system's members \$3 billion.¹⁸ In the end, the CalPERS board decided not merely to retain the ban on tobacco stocks but to broaden it.¹⁹

Such decisionmaking is reflected in the CalPERS announcement of its investment returns for the twelve months ending on June 30, 2020.²⁰ The net rate of return on over \$389 billion in assets was 4.7 percent; but the net rate of return for public equity — stocks traded publicly — was 0.6 percent. The S&P 500 benchmark over that period delivered a rate of return of 7.5 percent, that is, 6.9 percentage points higher than that realized by CalPERS on its public equity portfolio.²¹ Can anyone believe that ESG investing had little to do with this vast underperformance?

Note that some of the examples above are public pension funds. The Financial Factors rule appropriately applies to ERISA-managed private pension funds subject to ERISA constraints and requirements, as those funds are the focus of the Department's jurisdiction. But the evidence of ESG-related rate-of-return underperformance for CalPERS and other public pensions, and other investment funds as noted, demonstrates the larger reality of investment underperformance attendant upon ESG constraints. These examples offer central lessons for the importance of the Financial Factors rule. It would be appropriate also for the Department of Labor to send guidance to state authorities to exercise similar regulatory oversight over public pension funds with respect to ESG pressures.

Some continue to argue that ESG investment constraints do not yield lower returns — or that they yield even higher returns — systematically.²² Consider ESG investing that merely substitutes one ESG-favored set of companies (e.g., firms with small GHG footprints) in place of higher-GHG firms. Such a shift might mean that the artificial GHG constraint is small or non-

¹⁷ <https://mysfers.org/wp-content/uploads/08092017-board-meeting-07-fossil-fuel-A.pdf>.

¹⁸ <https://www.ft.com/content/e87a9b3c-0708-11e6-9b51-0fb5e65703ce>.

¹⁹ <https://www.calpers.ca.gov/page/newsroom/calpers-news/2016/votes-expand-tobacco-investment-ban>.

²⁰ See "CalPERS Reports Preliminary 4.7% Investment Return for Fiscal Year 2019-20," July 15, 2020, at <https://www.calpers.ca.gov/page/newsroom/calpers-news/2020/calpers-preliminary-investment-return-2019-20>.

²¹ See U.S. dollar "Factsheet," in *S&P 500*, S&P Dow Jones Indices, as of July 20, 2020, at <https://www.spglobal.com/spdji/en/indices/equity/sp-500/#overview>.

²² See e.g., <https://www.cnbc.com/2019/10/10/imf-research-finds-esg-sustainable-investment-funds-dont-underperform.html>.

existent; that is, that there is no meaningful constraint. An example might be a substitution of a technology company in place of an oil company. Because “ESG investing” has no straightforward definition, particularly in terms of constructing a portfolio, such investing can vary substantially in terms of firms and sectors.²³ It is no surprise that some subset of ESG investments might yield higher returns than non-ESG portfolios over some time period, merely because of inevitable shifts in economic conditions. But that observation ignores the longer-term reality: An artificial constraint on investment choices introduces a bias in investment choices toward, in our example, firms with low GHG footprints. Such a bias cannot be consistent with value maximization yielding higher returns over the long run.

Financial Risks and Future Anthropogenic Climate Change. The evaluation of the future effects of increasing atmospheric concentrations of GHG is highly complex, and an examination of the scientific debate reveals sharp disagreement on the magnitude of the effects on a global basis.²⁴ Such uncertainty is magnified greatly when “climate risks” are addressed on a regional basis, as the effects of increasing GHG concentrations will affect different regions differently, in ways understood poorly. The evaluation of such risks for individual firms is virtually impossible, that is, the statistical variance characterizing such estimates would be very high. Is it the position of the advocates of ESG investing that investment firms — even very large ones — are in a position to do such scientific and technical analysis of future climate phenomena, with resulting predictions that would support specific shifts in investments and the like? Or is it the goal of the proponents that a new class of consultants be created, whose predictions would add substantially to the uncertainties already face by given managements?

Even if such future climate effects were known with certainty, firms would have to evaluate the attendant impacts in terms of the market conditions — demand and supply shifts — that they would confront individually. Anyone attempting to predict shifts in future market conditions for a given sector or firms has an extremely difficult task; an attempt to predict the effects of one given factor among the myriad that are relevant is unlikely to prove viable. In short, the evaluation of climate risks is extremely difficult even on a global basis; it is nearly impossible for individual sectors or regions. Firms subjected to pressures to evaluate climate “risks” are in no position to do such climate analysis. This means necessarily that there will be a new market for the services of various proxy advisory firms and other such consultants, who will be in no better position to do climate analysis than anyone else, but whose recommendations will insulate managements from accusations of ignoring those climate “risks.” Such ESG meddling in firms’ decisions cannot be salutary in terms of value maximization for current and future retirees protected by ERISA.

²³ See James Mackintosh, “ESG Investing in the Pandemic Shows Power of Luck,” *Wall Street Journal*, July 15, 2020, at <https://www.wsj.com/articles/esg-investing-in-the-pandemic-shows-power-of-luck-11594810802>.

²⁴ See, e.g., Collins, M., *et. al.*, 2013: “Long-term Climate Change: Projections, Commitments and Irreversibility,” in Stocker, T.F., *et. al.*, eds., *Climate Change 2013: The Physical Science Basis. Contribution of Working Group I to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change*, Cambridge University Press, Cambridge, United Kingdom and New York, NY, USA, at http://www.climatechange2013.org/images/uploads/WGIAR5_WGI-12Doc2b_FinalDraft_Chapter12.pdf; and the various discussions and debates at Judith Curry, *Climate Etc.*, at <https://judithcurry.com/>.

III. The “Tie Breaker” Model of Non-Pecuniary Investment Criteria is Sophistry

The proposed Prudence and Loyalty rule attempts to circumvent these obvious realities by creating a “tie breaker” approval model for non-pecuniary investment factors: If alternative investment choices respectively with and without “non-pecuniary” dimensions serve the financial interests of fund participants equally, then an investment choice favoring the former would be deemed consistent with the fiduciary requirements of ERISA.²⁵ This approach is sophistry. The analysis of the prospective risk/return outcomes expected for a given investment choice necessarily is afflicted with various uncertainties; that is the inherent nature of “risk,” whether defined as a future outcome emerging from a set of possibilities with a known mean and variance or with such statistical properties not known.

Even a financial analysis focused narrowly on returns and risks must make choices among alternative assumptions, at least some of which necessarily are subjective. A clear explanation by fund managers of the rationales for such choices should satisfy the requirements of ERISA as long as the explanations are consistent with the overriding goal of advancing the fiduciary interests of fund participants. Once non-pecuniary objectives are introduced as investment criteria, the degree of subjectivity must increase, the choices among alternative assumptions about future financial outcomes must become more opaque, and the inexorable outcome would be a reduction in the importance of the fiduciary interests of fund participants, again as defined in ERISA.

IV. Any Change in ERISA Requirements Must Be Enacted by the Congress

The Department of Labor in the Prudence and Loyalty proposed rule is attempting to maintain that the proposed rule preserves the fiduciary requirements of ERISA. But *any* qualification of those requirements justified as consistent with ERISA in an effort to include non-pecuniary considerations in investment choices for funds governed by ERISA by definition cannot be consistent with ERISA in this context. The requirements of ERISA would be eroded by necessity, an outcome that would rewrite the law in a way inconsistent with the separation of powers imposed by the constitution. In short, the Prudence and Loyalty proposed rule in effect would rewrite ERISA; again, any such revision of the law must be enacted by the Congress. Accordingly, the proposed rule is inconsistent with the structure and constraints imposed by the constitution, and thus would erode our constitutional institutions.

V. Conclusions

The Prudence and Loyalty rule proposed by the Department of Labor cannot be made consistent with ERISA and the judicial decisions interpreting it, and thus with the fiduciary interests of participants in funds governed by ERISA, because the non-pecuniary factors proposed as investment objectives for such funds are immune to rigorous definition. They are, therefore, subjective, and thus inexorably political, inviting fund managers to substitute their political preferences to some degree in place of the fiduciary interests of plan participants as protected by ERISA. The “tie breaker” or “otherwise indistinguishable” model of non-pecuniary investment

²⁵ See the “tie breaker” discussion in the Prudence and Loyalty proposed rule beginning on p. 57273.

criteria cannot work as envisioned because analysis of future investment outcomes by definition is afflicted with important uncertainties, the resolution of which requires choices among alternative assumptions that cannot be quantified rigorously. They too are subjective and thus inexorably political.

A substantial body of evidence demonstrates that the insertion of non-pecuniary investment criteria in the management of pension and other such funds imposes a substantial penalty over time in terms of realized returns. This is not surprising: Such non-pecuniary criteria represent artificial constraints on investment choices and/or biases that interfere with the allocation of resources within a portfolio consistent with the various correlations and other investment characteristics that determine the financial outcomes yielded by fund performance. The data show that this is particularly the case for biases against investments in fossil-fuel sectors.

It is essential that the Department of Labor preserve the Financial Factors rule by not finalizing the Prudence and Loyalty rule. This is particularly important given the growing attempts, by many market participants and by those in a position to pressure firms, to use the resources of funds governed by ERISA to pursue goals inconsistent with value maximization for plan participants. Such goals inevitably must be politicized — no other outcome is possible — a deeply perverse set of constraints that even in principle cannot yield maximum (or the most beneficial) return/risk outcomes for current and future retirees protected by ERISA. Value maximization will serve their interests, and by allocating capital toward economic returns higher rather than lower also will serve to create an economy larger rather than smaller, an outcome beneficial for all consumers. Moreover, the Prudence and Loyalty proposed rule in effect would rewrite ERISA; any such revision of the law must be enacted by the Congress. Accordingly, the proposed rule is inconsistent with the structure and constraints imposed by the constitution, and thus would erode our constitutional institutions.