



The Forum for Sustainable and Responsible Investment

December 13, 2021

Ali Khawar
Acting Assistant Secretary
US Department of Labor
Room N-5655
200 Constitution Avenue NW
Washington, DC 20210

RE: Proposed rule on Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights (RIN 1210-AC03)

Dear Mr. Khawar:

On behalf of US SIF: The Forum for Sustainable and Responsible Investment, I welcome the opportunity to provide comments in response to the Department of Labor's (DOL) proposed rule, "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights" (RIN 1210-AC03) (the "Proposal").

US SIF is the leading voice advancing sustainable investing across all asset classes. Our mission is to rapidly shift investment practices toward sustainability, focusing on long-term investment and the generation of positive social and environmental impacts. Our members, comprised of investment management and advisory firms, mutual fund companies, asset owners, research firms, financial planners, advisors and broker-dealers, represent more than \$5 trillion in assets under management or advisement. US SIF members integrate environmental, social and governance (ESG) criteria into their investment decisions and take their responsibilities seriously as shareowners, including voting proxies and engaging with companies. Sustainable investing assets now account for \$17.1 trillion—or 1 in 3 dollars—of the total US assets under professional management, according to the US SIF Foundation's 2020 biennial *Report on US Sustainable and Impact Investing Trends*. This represents a 42 percent increase over 2018.¹ The report also shows a paucity of sustainable assets in retirement funds as a result of the regulatory uncertainty about ESG considerations in ERISA.²

Overview

US SIF has been engaged for many years in ensuring that guidance and rulemaking related to ERISA governed plans do not constrain the use of ESG criteria in portfolio construction or the ability of plans to vote proxies. We welcome the Proposal as it returns investment decision-making to fiduciaries and removes additional reporting and analysis requirements for ESG investments. The Proposal also sets out clear guidelines for fiduciaries to abide by when making

¹ Report on US Sustainable and Impact Investing Trends 2020: <http://www.ussif.org/trends>

² Ibid, p. 61

investment choices, including consideration of ESG criteria: “if a fiduciary prudently concludes that climate change or other ESG factor is material to an investment or investment course of action under consideration, the fiduciary can and should consider it and act accordingly.” It does not weigh against certain types of investments as the current rule does.

The Proposal removes the prohibition on ESG considerations in qualified default investment alternatives, or QDIA, which will better serve plan participants.

The Proposal recognizes that the proxy vote is an ownership right and removes safe-harbor provisions that may have suggested to fiduciaries that they need not vote proxies in certain circumstances.

Several recommended changes to the Proposal found below will make the final rule more adaptable over time and provide greater clarity to fiduciaries.

ESG criteria are relevant to investment risk-return analysis

US SIF commends the DOL for the Proposal and recognizing the importance of considering ESG criteria in retirement investments. Investment managers increasingly analyze ESG factors precisely because investment managers view those factors as material to financial performance with ample literature that makes clear that ESG criteria are material.³ Independent research firm ISS studied the relationship of ESG performance and the economic value added (EVA) margin of US companies with a market capitalization above \$250 million between 2013 and 2019.⁴ Their findings show that “high ESG performance is generally positively related to valuation and profitability and negatively correlated with volatility.” It also found “high ESG performance/high-EVA margin stocks tend to outperform.”

Two meta-studies arrive at the same conclusion. The first, published by The Journal of Sustainable Finance & Investment, considered 2,200 individual studies and reported that 90 percent of the studies found a non-negative relationship between ESG considerations and corporate financial performance, with a clear majority showing a positive relationship.⁵ The second, by Oxford University and Arabesque Partners, considered 200 sources and concluded, “88 percent of reviewed sources find that companies with robust sustainability practices demonstrate better operational performance, which ultimately translates into cash flow,” and “80 percent of the reviewed studies demonstrate that prudent sustainability practices have a positive influence on investment performance.”⁶

³ For a comprehensive list of research on materiality and performance of sustainable investments, please see the appendix of Impax Asset Management LLC’s comment letter in response to the “Financial Factors in Selecting Plan Investments” rulemaking (RIN 1210-AB95). <https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/public-comments/1210-AB95/00360.pdf>

⁴ ESG Matters, Dr. G. Kevin Spellman, CFA, David O. Nicholas. (2019)
https://www.issgovernance.com/file/publications/ISS_EVA_ESG_Matters.pdf

⁵ ESG And Financial Performance: Aggregated Evidence from More Than 2000 Empirical Studies, Gunnar Friede, Timo Busch, Alexander Bassen, Journal of Sustainable Finance & Investment (Volume 5, 2015 – Issue 4)
<https://www.tandfonline.com/doi/full/10.1080/20430795.2015.1118917>

⁶ From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance,” Gordon Clark, Andreas Feiner, Michael Viehs. University of Oxford and Arabesque Partners. (March 2015)
https://arabesque.com/research/From_the_stockholder_to_the_stakeholder_web.pdf

In addition, funds that use ESG criteria are consistent with long-term retirement objectives, with numerous studies showing that consideration of ESG criteria in investment analysis generally produces investment performances comparable to or better than non-ESG investments

For example, sustainable funds outperformed their peers during the Covid-19 pandemic. The 2021 Morgan Stanley Institute for Sustainable Investment study found that in a year of extreme volatility and recession, funds focused on “ESG factors, across both stocks and bonds, weathered the year better than non-ESG portfolios.”⁷ The research analyzed more than 3,000 US mutual funds and ETFs, finding that sustainable equity funds outperformed non-ESG peer funds by a median total return of 4.3 percent in 2020.

According to Morningstar’s 2021 Sustainable Funds US Landscape Report (February 2021), “[s]ustainable funds comfortably outperformed their peers in 2020, especially equity funds.” The returns of 69 percent of sustainable funds ranked in the top half of their Morningstar Category and 37 percent in the top quartile returns. Morningstar categorizes group funds, both sustainable and conventional, by similar characteristics such as region, market cap and style. Data for the past five years show similar results – the returns of 69 percent ranked in the top half and 41 percent in the top quartile returns. The report also compared the returns of ESG index funds to conventional index funds. Of 23 ESG index funds analyzed, 22 outperformed their relevant conventional index in 2020.

Consideration of ESG factors in QDIA is appropriate

Another important change made in the Proposal is the removal of the prohibition of ESG criteria in Qualified Default Investment Alternatives or QDIAs. The DOL correctly states that if a fund meets the standards set by the QDIA regulation,⁸ that fund can be chosen as a QDIA subject to the fiduciary’s duties to select and monitor the QDIA prudently.

The current rule unnecessarily limits QDIAs in section (d)(ii) of the final rule by prohibiting investments with strategies that “include, consider or indicate the use of one or more non-pecuniary factors.”⁹ The preamble of the current rule implies that ESG criteria are “non-pecuniary” and, in many cases, are unsuitable to the objective of providing secure and valuable retirement benefits.

By removing this prohibition, the DOL correctly asserts that the fiduciary standards for selecting other investment options for participant-directed plans (which allow for ESG considerations) should apply to QDIAs as well.

Proxy voting

Paragraph (d) of the Proposal makes important and necessary changes from the current rule. We are pleased that the Proposal removes safe-harbor provisions that may have suggested to fiduciaries that they need not vote proxies in certain circumstances and returns to the long-held standard that the proxy vote is an asset of the plan and should be stewarded as such.

Voting a proxy is one of the fundamental rights of owning shares. It is our view that the 2020 proxy voting rule intended to limit or dissuade fiduciaries from voting, which we believe is an

⁷ Sustainable reality: 2020 update, Institute

⁸ 29 CFR 2550.404c-5 (Fiduciary Relief for Investments in Qualified Default Investment Alternatives)

⁹ 85 FR 72846 (November 13, 2020)

inappropriate position for the DOL. In addition, a 2020 Harvard Business Law Review paper suggests that competition for proxy votes “generates ex-ante incentives for management to perform better, disclose information to shareholders in advance and to engage with institutional investors.”¹⁰

US SIF supports the position taken by the DOL in Interpretive Bulletin-2016-01, which stated that voting proxies and shareholder engagement were consistent with fiduciary duty, assuming that the practices had a reasonable expectation of positive impact on the plan after taking expenses into account. We disagree with the current rule’s statement that fiduciaries have a misunderstanding of the 2016 guidance and therefore find the current rule’s six-part test to be unnecessary. We also do not believe that there need to be special record-keeping requirements applied to the use of proxy advisory firms, which are a cost-efficient mechanism for fiduciaries to employ when voting proxies.

Suggested Changes to the Proposal

Examples of ESG criteria should be removed

The listing of specific climate change, governance and workforce practice criteria in paragraphs (b)(4) (i-iii) are too limited. Thus, the final rule should exclude examples in paragraph (b)(4) (i-iii) as the list may cause some fiduciaries to limit themselves to factoring in only those criteria.¹¹ We recognize that the DOL intends the list to be illustrative and not exhaustive. However, in the past, fiduciaries have considered examples as safe harbors. We believe the first paragraph of (b)(4) sufficiently addresses the breadth of criteria that can be considered: “A prudent fiduciary may consider any factor in the evaluation of an investment...that, depending on the facts and circumstances, is material to the risk-return analysis.”

In addition, a list of examples is limiting because ESG issues relevant to investors evolve over time. Climate risk is a prime example. When ERISA became law in 1974, few, if any, investors were considering climate risk in their investment analysis. We cannot predict what issues will emerge in the future.

Tie-breaker and collateral benefits concepts are outdated

We believe these terms are legacies of previous DOL guidance documents and are no longer relevant to considerations of ESG criteria under ERISA. Continuing to include the tie-breaker provisions creates the implication that there are occasions when ESG considerations are indeed collateral. It is our view, and increasingly the view of the broader financial services community as indicated by the rapid growth of sustainable investment assets, that ESG considerations are indeed financial and should not be treated as something “other” or “collateral.”

In addition, if an investment or an investment course of action is prudently determined to serve the interests of the plan participants, then the investment may be considered without the need

¹⁰ Nili, Yaron and Kastiel, Kobi, Competing for Votes (August 26, 2020). 10 Harvard Business Law Review 287 (2020), Univ. of Wisconsin Legal Studies Research Paper No. 1605, Available at SSRN: <https://ssrn.com/abstract=3681541>

¹¹ Should the Department include this list or a similar one in the final rule, please state that these are meant as examples and fiduciaries are not limited to considering only these ESG criteria.

for determining a tie. If several investments meet this threshold, it should be inconsequential what collateral benefits considerations the fiduciary makes to make a final selection.

Should the DOL keep tie-breaker and collateral benefits language in the final rule, we believe that the term “equally serve” in paragraph (c)(3) may not provide the clarity that fiduciaries need. A better alternative would be to allow collateral benefits after a fiduciary concludes that “equally prudent investments, or investment courses of action, serve the financial interests of the plan.” In addition, there would be a need for clarification that the tie-breaker concept should not be arbitrarily applied to individual investments, actions or time horizons when they are reasonably included as a component part of an aggregated investment strategy or course of action that serves the financial interests of plan participants.

Conclusion

The Proposal is an important step towards ending the regulatory pendulum limiting the inclusion of funds using ESG criteria in retirement plans and complicating proxy voting by plan fiduciaries. It recognizes that the consideration of ESG criteria is part of the investment process and should be treated like any other investment criteria used by plan fiduciaries under the duty of loyalty and care. Significantly, the Proposal removes the barriers created by the 2020 rules for ESG consideration in QDIA. The Proposal also recognizes the proxy vote as an ownership right and removes provisions that may have discouraged fiduciaries from exercising their ownership rights.

Should the Proposal become final, including the recommended changes above, it will give clear guidance to fiduciaries on the use of ESG criteria in plan investments and allow plan participants to benefit from access to sustainable investment options.

Thank you for your consideration of these comments. Please feel free to contact me at lwoll@ussif.org with any questions.

Sincerely,



Lisa Woll
CEO