



July 30, 2020

Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

Re: Financial Factors in Selecting Plan Investments
Proposed Regulation (RIN 1210-AB95)

Dear Director Canary:

On behalf of the Americans for Financial Reform Education Fund (“AFREF”), thank you for the opportunity to submit comments on the notice of proposed rulemaking entitled “Financial Factors in Selecting Plan Investments” (“Proposal”). AFREF is concerned that, instead of clarifying the DOL’s views on ESG investing, the Proposal will create confusion among fiduciaries, will cause fiduciaries to ignore material ESG factors, and result in poor investment choices that result in losses for retirement savers. As a result, we urge the DOL to withdraw the Proposal.

AFREF is a coalition of more than 200 national, state, and local groups who have come together to advocate for reform of the financial industry. Members of AFREF include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups.¹

Under current DOL policy, ERISA fiduciaries typically select investment options that integrate ESG factors into their investment practices because they believe those investments are superior from a risk and return perspective. Alternatively, fiduciaries may determine that multiple investment options are substantially similar from an economic perspective and apply the “all things being equal test” to select an option because of collateral benefits. The Proposal, however, will undermine current investment practice.

If finalized in its current form, the Proposal will:

- Discourage fiduciaries from integrating material ESG factors into their investment activities;
- Impose onerous new processes on fiduciaries who seek to consider ESG factors; and

¹ A list of coalition members is available at: <https://ourfinancialsecurity.org/about/our-coalition/>

- Deny fiduciaries the opportunity to select the best investments from a risk and return perspective.

In spite of the DOL statement that it is trying to prevent the selection of investments based on the fiduciaries personal preferences,² it appears that, the DOL is being driven by its own political desires to fulfill the President’s executive order that demanded the DOL find ways to facilitate ERISA covered plans’ investment in the energy sector.³ The Proposal will impose new costs on beneficiaries, undermine American’s retirement security, and impede investment decisions that would lead to a more sustainable economy and society. For these reasons, we urge the DOL to withdraw the Proposal.

The Proposal Causes Confusion and Will Have a Chilling Effect on ESG Investing

The Proposal puts forward two circumstances in which fiduciaries may consider ESG factors as part of their investment practice:

1. “[I]f they present economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories;”⁴ and
2. If multiple investment options are determined to be “economically indistinguishable,” fiduciaries may select an investment because of “non-pecuniary” factors such as ESG factors.⁵

The discussion in the Proposal presents an inconsistent view of whether ESG factors may be considered economically material, or, pecuniary. The Proposal states that, “ESG factors and other similar factors may be economic considerations.”⁶ It also states, however, that “ESG investing raises heightened concerns under ERISA.” It prohibits ERISA fiduciaries from selecting a default investment option for a participant directed plan that includes an ESG mandate because the DOL “does not believe that investment funds whose objectives include non-pecuniary goals – even if selected by fiduciaries only on the basis of objective risk-return criteria... should be the default investment option.”⁷

The DOL’s divergent characterizations of ESG factors as pecuniary and non-pecuniary will cause confusion for fiduciaries. We are concerned that, as a result, ERISA fiduciaries will choose to ignore even material ESG factors because they are concerned that the DOL will disagree with their determination and they will be subject to enforcement action. Alternatively, fiduciaries may feel obligated to fulfill the requirements the Proposal imposes on investment selections made pursuant to the “all else being equal test” to protect themselves against

² 85 FR 39119

³ Executive Order on Promoting Energy Infrastructure and Economic Growth, April 10, 2019, *available at* <https://www.whitehouse.gov/presidential-actions/executive-order-promoting-energy-infrastructure-economic-growth/>.

⁴ Proposed § 2550.404a-1(c)(1)

⁵ Proposed § 2550.404a-1(c)(2)

⁶ Proposed § 2550.404a-1(c)(1)

⁷ Proposed § 2550.404a-1(c)(3)(iii)

enforcement actions arising out of a disagreement with the DOL about whether it was proper to determine those factors to be pecuniary and, therefore, satisfy the first test.

The Proposal imposes onerous new procedural burdens on fiduciaries who seek to consider ESG factors and creates confusion about the proper application of the “all things being equal test”

The DOL’s first policy pronouncements related to consideration of ESG factors by ERISA fiduciaries were made in response to fiduciaries’ desires to invest in economically targeted investments (ETIs). The DOL has defined ETIs as “investments that are selected for the economic benefits they create in addition to the investment return to the employee benefit plan investor.”⁸ The DOL created the “all things being equal test,” to allow fiduciaries, in limited circumstances, to invest in ETIs. It allows fiduciaries to select an investment that creates collateral or non-pecuniary benefits if they determine that the risk and return profile of that investment option is equivalent to that of other options that would meet the financial needs of the plan just as well.

As discussed above, the Proposal’s schizophrenic characterization of ESG factors as pecuniary or non-pecuniary may lead fiduciaries to conclude that the most prudent course of action is to apply the “all things being equal test” any time they consider ESG factors as part of their investment decision making process. As a result, fiduciaries for all plans that consider ESG factors as part of their investment processes are likely to be burdened with the additional costs created by the Proposal’s recordkeeping obligations for fiduciaries, which require documentation of their analysis that multiple options were economically equivalent and that it was, therefore, permissible to consider ESG factors.

The Proposal also creates uncertainty about how the DOL will view fiduciaries’ determination to apply the test. It raises questions about whether the DOL would accept a determination by fiduciaries that multiple investment options present identical economic opportunities, stating “the Department believes that truly economically indistinguishable alternatives are rare.”⁹

Ultimately, the Proposal’s confusing characterization of the materiality or pecuniary nature of ESG factors, combined with Department’s discouragement of the application of the “all things being equal test” and the additional burdens fiduciaries seeking to apply that test will have to fulfill, is likely to have a substantial chilling effect on integration of ESG factors into investment decisions by ERISA fiduciaries. People saving for retirement will suffer the losses as fiduciaries are strong-armed by DOL regulation into selecting inferior investment products that fail to consider material risks.

The Proposal denies fiduciaries the opportunity to select the best investments from a risk and return perspective

⁸ Federal Register, *Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments*, (October 26, 2015) available at: <https://www.federalregister.gov/documents/2015/10/26/2015-27146/interpretive-bulletin-relating-to-the-fiduciary-standard-under-erisa-in-considering-economically>.

⁹85 FR 39118

As discussed above, the Proposal will have a chilling effect on fiduciaries seeking to integrate ESG factors into their investment practices even when they have determined that investment options that integrate ESG factors are superior from a risk and return perspective. In addition, the Proposal would prohibit an “ESG-themed fund” from being selected as the default investment option for a 401(k) plan. It appears that that portion of the Proposal is driven by a mischaracterization by the DOL of the pecuniary nature of ESG factors.

In explaining its rationale, the Proposal states, “The Department does not believe that investment funds whose objectives include non-pecuniary goals—even if selected by fiduciaries only on the basis of objective risk-return criteria...—should be the default investment option in an ERISA plan.”¹⁰ It appears, based on this statement, that the DOL misunderstands ESG investment strategies.

In fact, it has become common practice for traditional asset managers to consider ESG factors because of a growing understanding that they impact investment returns. A recent GAO report found that 12 of the 14 large institutional investors who participated in the report consider ESG information to make investment decisions because they believe ESG factors will have a pecuniary impact on their investments.¹¹

DOL policy has always focused on process, not outcome. In an unprecedented move, this Proposal mandates an outcome that would require fiduciaries to select an investment option that is not the best selection based on the conclusions arrived at after following the mandated considerations of financial factors such as risk, return, liquidity and fees. In spite of the DOL statement that it is trying to prevent the selection of investments based on the fiduciaries personal preferences,¹² it appears that, in fact, the DOL is being driven by its own political desires to fulfill the President’s executive order that demanded the DOL find ways to facilitate ERISA covered plans’ investment in the energy sector.¹³

The DOL is, in effect, proposing to undermine peoples’ retirement security in order to advance the Trump administration’s political goals.

Conclusion

Investors are increasingly integrating ESG considerations into their investment practices because there is now overwhelming evidence that they are financially material. Given the evolution of the research in recent years, the DOL Proposal is a move in the wrong direction. Instead of acting to hold back evolution in responsible investing, the Department should Propose a rule that requires that fiduciaries integrate ESG factors into their investment practices. For these reasons, we urge the DOL to withdraw the Proposal

¹⁰ 85 FR 39119

¹¹ See GAO-20-530: *PUBLIC COMPANIES: Disclosure of Environmental, Social, and Governance Factors and Options to Enhance Them*, July 2, 2020, available at: <https://www.gao.gov/assets/710/707949.pdf>.

¹² 85 FR 39119

¹³ Executive Order on Promoting Energy Infrastructure and Economic Growth, April 10, 2019, available at <https://www.whitehouse.gov/presidential-actions/executive-order-promoting-energy-infrastructure-economic-growth/>.

Thank you for the opportunity to share our views. For further conversation, please feel contact Heather Slavkin Corzo at heather@ourfinancialsecurity.org.