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

Attn: RIN 1210-AB95
Financial Factors in Selecting Plan Investments Proposed Regulation

Via: Federal eRulemaking Portal: www.regulations.gov

DALBAR appreciates the opportunity to comment on the Financial Factors in Selecting Plan Investments Proposed Regulation ("*Proposed Regulation*").

DALBAR Background

DALBAR has a 40-year history and is recognized by industry and government as an independent third-party expert in the business of providing evaluations, ratings, and due diligence. DALBAR certifications are recognized as a mark of excellence in the financial community for financial services in general and specifically for retirement plans.

In 2020 DALBAR launched an initiative to enhance the effectiveness of retirement plans by establishing standards that reflect both ERISA and the goals of Environment, Social and Governance practices ("ESG"). We intend to certify plans that meet these standards and thus encourage responsible plan fiduciaries to enhance their plans by managing costs, providing greater benefits to participants, and adopting high standards of governance.

This DALBAR initiative differs greatly from the ESG Investments that are the subject of the *Proposed Regulation* since the DALBAR certification is based on the overall success of the plan in achieving retirement security for the maximum number of employees. The plans for this initiative have been submitted to Office of Regulations and Interpretations for a review.

Introduction

The *Proposed Regulation* does not explicitly recognize the two most important pecuniary factors that are the participation in and contributions to a plan. There is no question that these pecuniary factors have a more significant effect than investment results in enhancing retirement security.

The history of defined contribution plans bears witness to the fact that the public preference for a type of investment has been a central factor in participation and contribution levels and therefore the ultimate success of a retirement plan. In the early 1980's GICs were the de facto standard for defined contribution ("DC") plans, but when mutual funds were introduced to DC plans, the plans grew by orders of magnitude in the number of employees covered and the level of retirement income they produced. This was not because mutual funds were economically superior to other available investments (their costs were often greater and risk-adjusted returns were not the highest), it was because mutual funds were becoming popular with the public.

We face a similar threshold today. The question of the day being "should ESG be an included consideration for retirement plans because of the consequential effect on the most important pecuniary factors of participation and contribution?" This would be in addition to the assessment of risk and return of ESG investments included as investments in the plan.

DALBAR's most recent employee survey[1] answers this question. It shows that there is a great public appetite for participating in and contributing to plans that include ESG Investments. In fact, 76% of employees said they were more likely to participate in plans that included ESG Investments. Furthermore 32% said they were very likely to participate in such plans.

General Comments

SUMMARY: *The Department of Labor (Department) in this document proposes amendments to the "Investment duties" regulation under Title I of the Employee Retirement Income Security Act of 1974, as amended (ERISA), to confirm that ERISA requires plan fiduciaries to select investments and investment courses of action based solely on financial considerations relevant to the risk-adjusted economic value of a particular investment or investment course of action.*

Comment:

- "*financial considerations*" should include any factor that predictably will influence the "*economic value*" of a "*course of action*". Financial Considerations must include courses of action that lead to increased economic value. The primary courses of action are:
    - Participation in a plan that makes the economic value possible
    - Contributions to the plan that provide the initial capital
    - Investment choices that seek to increase the initial capital

Sections 403(c) and 404(a) also require fiduciaries to act solely in the interest of the plan's participants and beneficiaries, and for the exclusive purpose of providing benefits to their participants and beneficiaries and defraying reasonable expenses of administering the plan. 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,"1 observing that their decisions must "be made with an eye single to the interests of the participants and beneficiaries."2 The Supreme Court as recently as 2014 unanimously held in the context of ERISA retirement plans that such interests must be understood to refer to "financial" rather than "nonpecuniary" benefits,3 and federal appellate courts have described ERISA's fiduciary duties as "the highest known to the law."4 The Department's longstanding and consistent position, reiterated in multiple forms of sub-regulatory guidance, is that plan fiduciaries when making decisions on investments and investment courses of action must be focused solely on the plan's financial returns and the interests of plan participants and beneficiaries in their plan benefits must be paramount.

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.

[1] See DALBAR survey report, "Financial Success Drivers of DC Plans"

Comment

- Investments selected because of the measurable <u>financial merits</u> of plan participation and plan contribution are therefore permitted. It becomes incumbent on fiduciaries to establish the economic rationale for inclusion of ESG investments. These include practices and targets for increased participation and contribution that are expected to be achieved by the inclusion of ESG investments.

*Pension plans covered by ERISA are statutorily-bound to a narrower objective: management with an "eye single" <u>to maximizing the funds available to pay retirement benefits</u>. Providing a secure retirement for American workers is the paramount, and eminently-worthy, "social" goal of ERISA plans; <u>plan assets may **not** be enlisted in pursuit of other social or environmental objectives</u>.*

Comment:

- Participation and contributions are essential "*<u>to maximizing the funds available to pay retirement benefits".</u>*

Requested Comments

The Department and OMB are particularly interested in comments that address the following:

- *Evaluate whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;*
  - *Pecuniary factors of increased participation and contribution are omitted.*
  - *Financial strength of issuer is a key risk factor when any form of guarantee is being considered.*
- *Evaluate the accuracy of the agency's estimate of the burden of the collection of information, including the validity of the methodology and assumptions used;*
  - *The estimated burden does not include costs currently paid by investment managers of ESG investments that will not be funded if the ESG investment is removed from the plan.*
- *Enhance the quality, utility, and clarity of the information to be collected; and*
  - *It is necessary to clarify to participants that the reason for including ESG funds is to make the plan more appealing to those who share ESG values.*
- *Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology (e.g., permitting electronic submission of responses).*

Suggested Changes to *Proposed Regulation*

Section (b)(v)(2)

(v) Has acted accordingly.

(2) For purposes of paragraph (b)(1) of this section, "appropriate consideration" shall include, but is not necessarily limited to,

(i) A determination by the fiduciary that the particular investment or investment course of action is reasonably designed, as part of the portfolio (or, where applicable, that portion of the plan portfolio with respect to which the fiduciary has investment duties), to further the purposes of the plan, taking into consideration the retirement outcome, risk of loss and the opportunity for gain (or other return) associated with the investment or investment course of action, and

(ii) Consideration of the following factors as they relate to such portion of the portfolio:

(A) The composition of the portfolio with regard to diversification;

(B) The liquidity and current return of the portfolio relative to the anticipated cash flow requirements of the plan;

(C) The projected return of the portfolio relative to the funding objectives of the plan; and

(D) How the investment or investment course of action compares to available alternative investments or investment courses of action with regard to the factors listed in paragraphs (b)(2)(ii)(A) through (C) of this section;

(E) The potential effect on plan participation and contributions.

Section (c)

(1) Consideration of Pecuniary vs. Non-Pecuniary Factors. A fiduciary's evaluation of an investment must be focused only on pecuniary factors. Plan fiduciaries are not permitted to sacrifice investment return or take on additional investment risk to promote non-pecuniary benefits or any other non-pecuniary goals. Environmental, social, corporate governance, or other similarly oriented considerations are pecuniary factors only if they present economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories. The weight given to those factors should appropriately reflect a prudent assessment of their impact on plan participation, risk and return. Fiduciaries considering environmental, social, corporate governance, or other similarly oriented factors as pecuniary factors are also required to examine the effect on participation, level of contributions, level of diversification, degree of liquidity, and the potential risk-return in comparison with other available alternative investments that would play a similar role in their plans' portfolios.

(3) Investment Alternatives for Individual Account Plans. The standards set forth in sections 403 and 404 of ERISA and paragraphs (b)(1) and (b)(2) of this regulation apply to a fiduciary's selection of an investment fund as a designated investment alternative in an individual account plan. In the case of investment platforms for defined contribution individual account plans, including platforms with bundled administrative and investment services, that allow plan participants and beneficiaries to choose from a broad range of investment alternatives as defined in 29 CFR 2550.404c-1(b)(3), a fiduciary's addition (for the platform) of one or more prudently selected, well managed, and properly diversified investment alternatives that include one or more environmental, social, corporate governance, or similarly oriented assessments or judgments in their investment mandates, or that include these parameters in the fund name, would not violate the standards in section 403 and 404 provided:

> *(i) the fiduciary uses only objective outcome and risk-return criteria, such as potential increases in participation and contribution, benchmarks, expense ratios, fund size, long-term investment returns, volatility measures, investment manager investment philosophy and experience, financial strength of issuer and mix of asset types (e.g., equity, fixed income, money market funds, diversification of investment alternatives, which might include target date funds, value and growth styles, indexed and actively managed funds, balanced and equity segment funds, non-U.S. equity and fixed income funds), in selecting and monitoring all investment alternatives for the plan including any environmental, social, corporate governance, or similarly oriented investment alternatives;*

(f) Definitions

(3) The term "pecuniary factor" means a factor that has a material effect on retirement outcome, risk and/or return of an investment based on participation and contributions, appropriate investment horizons consistent with the plan's investment objectives and the funding policy established pursuant to section 402(a)(1) of ERISA.

Adopting the suggested changes will not limit the effectiveness of the Proposed Regulation but will also undoubtedly increase the number of employees covered and the retirement income derived from retirement plans.

Regards,

Louis S Harvey
President & CEO