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July 29, 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,
Attention: Financial Factors in Selecting Plan Investments Proposed Regulation

By electronic transmission to Federal eRulemaking Portal: www.regulations.gov.

Re: RIN 1210–AB95 a proposed U.S. Department of Labor rule
pertaining to Financial Factors in Selecting Plan Investments
released in 85 Fed. Reg. 39,113 (June 30, 2020)

Dear Madam or Sir:

My firm, the Law Offices of Albert Feuer, with law offices in New York City focuses on employee benefits, executive compensation, estate planning and administration, and related tax issues. I have written extensively on employee benefits issues. I am submitting these comments in my private capacity, not on behalf of any client.

Summary of Comments

It is advisable for the U. S. Department of Labor (DOL) to revise the proposed ERISA duties regulation the DOL published in 85 Fed. Reg. 39,113 (June 30, 2020) (the "DOL ESG Proposal") in order to:

- Recognize the primacy of an investment's expected economic benefits in the selection of a self-directed plan's qualified default investment alternative (QDIA), which in turn may, but need not, take into account environmental, social, and corporate governance considerations;

- Recognize that ERISA plan fiduciaries making investments need not limit their consideration to those financial criteria that determine the investment's expected economic value;
- Permit, but not require, ERISA plan fiduciaries to use any non-pecuniary consideration to make or monitor investments if such consideration is not prohibited by law, such as one based on racial, religious, or sex discrimination, and will not (1) diminish the investment's expected economic value, or (2) displace an investment alternative addressing the same asset class with a superior expected economic value;
- Set forth the duty of ERISA plan fiduciaries to (1) review and to monitor the expected and actual economic benefits from all their investment decisions which duty is unaffected by whether the fiduciary or the investment is taking into account environmental, social, and corporate governance considerations, and (2) maintain records of these actions. Less stringent requirements should govern fiduciaries of small plans, i.e. those with either a limited number of participants or assets; and
- Define all terms used in the proposed regulation in the regulation not only in the preamble.

Comments

ERISA plan fiduciaries may select investments to make (1) directly on behalf of plan participants and beneficiaries, or (2) indirectly on behalf of plan participants and beneficiaries by selecting investment options to offer them. The DOL ESG proposal directs fiduciaries to look askance at environmental, social and governance investing, which the DOL describes in the preamble as including socially responsible investing, responsible investing, and sustainable investing (ESG/sustainable investing). The DOL ESG proposal only permits ESG/sustainable investments by a plan fiduciary if the fiduciary overcomes burdens not applicable to other investing approaches regardless of the economic value of the investment, even though recent studies such as Jon Hale, *How U.S. ESG Funds Outperformed Conventional Funds in 2019*, MORNINGSTAR (Apr. 16, 2020), https://www.morningstar.com/articles/973590/us-esg-fundsoutperformed-conventional-funds-in-2019 , and Ľuboš Pástor and M. Blair Vorsatz, *Mutual Fund Performance and Flows During the COVID-19 Crisis*, CHICAGO BOOTH PAPER NO. 20-18 (July 10, 2020), http://ssrn.com/abstract=3648302, show that the class of ESG/sustainable funds have outperformed other funds. The DOL ESG proposal prohibits a self-directed plan, from making an ESG/sustainable investment, regardless of its economic value, (a) a QDIA or a component of a QDIA, or (b) any kind investment alternative if the fiduciary applied any ESG/sustainable investment considerations, such as ESG ratings, that are not "objective risk-return criteria."

Participants and beneficiaries, like other investors often seek and make ESG/sustainable investments not only because such investments, like other investments, are perceived as good economic investments, but because, unlike other investments, they are also perceived to be ethically beneficial (that need not fit within the ESG/sustainable rubric) without sacrificing any economic value. Thus, plan sponsors try to accommodate them by making such investments and distributing regular reports to them about the extent of those ethical benefits. However, under the DOL ESG proposal, plan fiduciaries would no longer be able to choose or retain ESG/sustainable friendly version of asset classes provide at least the economic value of other available members of an asset class, such as an S&P 500® ESG Index fund rather than an S&P 500® Index fund, if they also take into account not only the investment's economic value, but its environment, society, and enterprise governance benefits.

The proposed regulations rely on three incorrect basic premises.

The most basic and incorrect premise is that ERISA plan fiduciaries who follow ERISA § 404(a)(1)(B) and act as careful, prudent, skillful, and diligent investment managers will, like the DOL and unsophisticated individuals, rely on slogans, such as those denigrating or praising ESG/sustainable investing, to make direct or indirect plan investment decisions. Instead, as suggested in the proposal's preamble, such fiduciaries would determine the economic value of the available alternatives in the relevant asset class, without regard to the name of each alternative or the investment approach of each alternative, and thereby identify the alterative or alternatives with the greatest economic value, which could, but need not, include an ESG/sustainable alternative.

The second basic and incorrect premise is that the ‘‘benefits’’ to be pursued by ERISA fiduciaries may not include ‘‘nonpecuniary benefits.” None of the cited decisions so held. Instead, each held that fiduciaries may not sacrifice an investment's economic benefits, i.e., its economic value, to obtain nonpecuniary benefits. None discussed whether a fiduciary may use non-economic benefits to decide between several investments of equal economic value.

The third basic and incorrect premise is that plan fiduciaries may never use non-pecuniary factors to make indirect investment decisions, and may only use non-pecuniary factors for direct investment decisions in those rare “unicorn” cases when deciding between economically indistinguishable investments. This unicorn-like characterization fails to recognize that prudent fiduciaries often find multiple options provide the same best economic value, sometimes as a result of searching quite deliberately for an ESG/sustainable alternative to another fund, such as an S&P 500® ESG Index fund as an alternative to an S&P 500® Index fund. This is customary with both direct or indirect investments. In those cases, the fiduciaries may and must choose one or more of those options for reasons other than the options' equal economic value. Thus, fiduciaries must rely on considerations, such as personal comfort with the managers of the different options or ESG/sustainable factors. However, because in almost all those cases, those investments are economically distinguishable under the DOL ESG proposal's characterization, the proposal would either paralyze fiduciaries in many customary situations or tempt them to find non-existent economic value differences to justify their investment choices.

Conclusions

Therefore, as described in my attached article, The Premises of the Proposed Regulation for Selecting ERISA Plan Investments, 61 TAX MGMT. MEMO. 227 (August 3, 2020), it is advisable for the DOL to revise the proposed ERISA duties regulation to be consistent with ERISA, the usual practice of ERISA plan fiduciaries fulfilling their investment duties, the prior DOL guidance, and the reasonable preferences of many ERISA plan fiduciaries, participants, and beneficiaries for investments that provide ethical benefits that may be monitored, but which they do not sacrifice any economic value, and often, but not always, thereby obtain better economic returns.

I would be happy to meet with staff or provide any additional information that may be of use in developing a record or analysis of ESG/sustainable investments.

Respectfully submitted,

Albert Feuer

Albert Feuer

ARTICLES

The Premises of the Proposed Regulation for Selecting ERISA Plan Investments

*By Albert Feuer**
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Forest Hills, NY

On June 30, 2020, the U.S. Department of Labor (DOL) published, in the Federal Register, proposed amendments to the investment duties regulations for Title I of to the Employee Retirement Security Act of 1974, as amended (ERISA),[1] with a particular focus on what is described therein as ESG investment issues (the "DOL ESG Proposal").[2] On June 23, 2020, the DOL news release accompanying the June 23, 2020, release of a preliminary form of the DOL ESG Proposal declared that "[p]rivate employer-sponsored retirement plans are not vehicles for furthering social goals or policy objectives that are not in the financial interest of the plan," said Secretary of Labor Eugene Scalia, "[r]ather, ERISA plans should be managed with unwavering *focus on a single, very important social goal*: providing for the retirement security of American workers."[3] This has never been the DOL position because it is not consistent with ERISA, with how investment advisors must behave in the real world, or with the ERISA plan benefits that many participants and beneficiaries receive and expect to receive.

THE DOL ESG PROPOSAL AND THE REACTION TO THE PROPOSAL

The DOL ESG Proposal expresses concern that investment decisions are being made "because of the non-pecuniary benefits they may further, such as those relating to environmental, social, and corporate governance considerations."[4] The DOL ESG proposal criticizes the lack of consensus about ESG ratings or ESG investing.[5] However, this lack of ESG rating consensus is a positive feature that recognizes that different investors have different ESG preferences which are reflected in different preferred ESG ratings.[6] The DOL ESG proposal defines an ESG investment mandate as an investment mandate that is an environmental, social, and corporate governance-oriented assessment or judgment, and an ESG-themed fund as one that includes an ESG parameter in its name or has an ESG investment mandate, but does not define such assessments or judgments.[7] The proposed regulation, however, would limit the ability of plan fiduciaries, who unlike individual investors must act prudently, to make investments that take into account any non-pecuniary benefits, such as ESG benefits,[8] or would make "ESG-themed funds" available to plan participants and beneficiaries.[9]

The apparent urgency of implementing these new rules is shown by the 30-day comment period, all comments must be submitted on or before July 30, 2020.[10] The DOL ESG proposal, however, presents no evidence of an ERISA plan's economic perfor-

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* Albert Feuer is the principal attorney in the Law Offices of Albert Feuer, Forest Hills, N.Y. The firm focuses on employee benefits, executive compensation, estate planning and administration, and related tax issues. The author thanks Anna Masilela, whose many thoughtful ideas and insights were instrumental in preparing this article. Copyright© Albert Feuer 2020.

1 Pub. L. No. 93-406.

2 DOL ESG Proposal, 85 Fed. Reg. 39,113 (June 30, 2020).

3 U.S. Department of Labor Proposes New Investment Duties Rule, U.S. Dept of Labor Employee Benefit Security Administration (June 23, 2020), https://www.dol.gov/newsroom/releases/ebsa/ebsa20200623-0 (emphasis added).

4 DOL ESG Proposal at 39,114. This is followed by the sentence, "[v]arious 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."

5 DOL ESG Proposal at 39,115. *Cf. Public Companies: Disclosure of Environmental, Social, and Governance Factors and Options to Enhance Them*, U.S. Gen. Acct. Off. GAO-20-530 (July 2020), https://www.gao.gov/assets/710/707949.pdf (concluding options to improve the quality and usefulness of ESG disclosures pose important trade-offs).

6 *See* Feifei Li & Ari Polychronopoulos, *What a Difference an ESG Ratings Provider Makes!,* Research Affiliates (Jan. 2020), https://www.researchaffiliates.com/en_us/publications/articles/what-a-difference-an-esg-ratings-provider-makes.html (finding that different ESG ratings from different agencies lead to different ESG portfolios with different risk-reward profiles and recommending that investors choose the ratings best correlated with their ESG views). This was the most recent article cited in the DOL ESG Proposal at 39,115, n. 14, in support of the statement about the existence of inconsistent ESG ratings.

7 DOL ESG Proposal at 39,118.

8 DOL ESG Proposal at 39,127, Proposed 29 C.F.R. §2550.404a-1(c)(1)-§2550.404a-1(c)(2).

9 DOL ESG Proposal at 39,127, Proposed 29 C.F.R. §2550.404a-1(c)(3).

10 DOL ESG Proposal at 39,113. In general, the comment period is between 30 and 60 days. A *Guide to the Rulemaking Process,* Office of the Federal Register (Jan. 2011) at 5, https://www.federalregister.gov/uploads/2011/01/the_rulemaking_process.pdf. Moreover, the DOL did not issue an

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mance suffering because of ESG considerations under the current rules.[11] The DOL ESG proposal seems to be a reaction to ESG successes rather than its failures, such as the growing popularity of ESG investments mentioned therein.[12] Moreover, the DOL ESG proposal does not mention how ESG proposals are effective on their own terms such as helping to create more diverse corporate boards.[13] Nor does it mention the considerable evidence that ESG investing is often quite economically advantageous, such as the Morningstar study concluding that in 2019, and in each of the four prior years, that American sustainable funds, which include ESG funds, outperformed other funds.[14] Thus, in March of 2020, three of the largest public pension plans in the world, Japan's $1.57 trillion Government Pension Investment Fund (GPIF), the $252.4 billion California State Teachers' Retirement System (CalSTRS), and the UK's $89 billion Universities Superannuation Scheme (USS) so disagreed with DOL ESG Proposal's concern about the deleterious effects of ESG investing that they issued statement that enterprises that fail to heed their call ''are not attractive investment targets for us,'' and asset managers that also fail to do so ''are not attractive partners for us.''[15] As of July 6, 2020, the statement had 12 more signatories, including several additional pension funds.[16]

A very respected commentator entitled his description of the DOL ESG Proposal, EBSA Proposal Pours Some Cold Water on ESG Enthusiasm.[17] Other commentators were more circumspect in their title, but

Advance Notice of Proposed Rule-making in the Federal Register, which would have given the public a formal role in shaping the proposed regulation. *See Guide to the Rulemaking Process* at 3. Questions have been raised about whether the DOL ESG Proposal complies with the other applicable requirements for the promulgation of a regulation. *See, e.g.,* Robert A.G. Monks and Nell Minow, Comment Letter on DOL Proposed Rule on ESG Investments (July 25, 2020), Harv. L. Sch. F. Corp. Governance (July 25, 2020),https://corpgov.law.harvard.edu/2020/07/25/comment-letter-on-dol-proposed-rule-on-esg-investments/ (explaining why the authors believe that the proposal does not meet the minimum requirements of the Administrative Procedure Act, the Paperwork Reduction Act, Office of Information and Regulatory Affairs guidelines, or cost-benefit standards).

[11] *But see* DOL ESG Proposal at 31,115, n. 15 (observing that average ESG fund fees exceed those of S&P® index fees, as is the case for almost any non-S&P® index fund, but no prudent ERISA plan fiduciary would limits its investments to the S&P index funds because the fiduciary needs to diversify its investments and may expect good financial performance from other funds, including an actively managed fund, all of which, not only ESG funds, charge far higher fees than S&P® index fees).

[12] DOL ESG Proposal at 39,155 (declaring ''[f]or example, according to Morningstar, the amount of assets invested in so-called sustainable funds in 2019 was nearly four times larger than in 2018'').

[13] *See, e.g.,* Jared Landaw, *Maximizing the Benefits of Board Diversity: Lessons Learned from Activist Investing,* Harv. L. Sch. F. Corp. Governance (July 14, 2020), https://corpgov.law.harvard.edu/2020/07/14/maximizing-the-benefits-of-board-diversity-lessons-learned-from-activist-investing/ (describing how pressure from institutional investors has helped increased the proportion of women, racial, and ethnic minorities who being named to corporate boards, and arguing for the importance of looking for cognitive diversity while broadening demographic diversity), and Ruth Umoh, *The Last All-Male Board On The S&P 500 Just Added A Female Member,* Forbes (July 25, 2019), https://www.forbes.com/sites/ruthumoh/2019/07/25/the-last-all-male-board-on-the-sp-500-just-added-a-female-member/#6631657b399d (describing the appointment of a woman to the board of the 500th S&P 500® company).

[14] Jon Hale, *U.S. ESG Funds Outperformed Conventional Funds in 2019,* Morningstar (Apr. 16, 2020), https://www.morningstar.com/articles/973590/us-esg-funds-outperformed-conventional-funds-in-2019 (reporting this is the fifth consecutive year of overperformance, which means that ESG funds had disproportionately high representations in each of the higher performance quartiles of their asset categories, but not that each ESG fund did better than each non-ESG fund, and observing this is not due merely to the overweighting of technology enterprises or the underweighting of energy enterprises). This was a month after the cited Morningstar study that ESG investment had increased four times between 2018 and 2019.

[15] *See* Michael Katz, *Trio of Pension Giants Takes on ESG Naysayers,* Chief Investment Officer (Mar. 6, 2020), https://www.ai-cio.com/news/trio-pension-giants-takes-esg-naysayers/ (describing the announcement of this policy) and *Our Partnership for Sustainable Capital Markets,* California State Teachers' Retirement System, [Japanese] Government Pension Investment Fund, & [UK] Government Pension Investment Fund, https://www.gpif.go.jp/en/investment/Our_Partnership_for_Sustainable_Capital_Markets.pdf (the pension plan's statement).

[16] Joint statement on the importance of long-term, sustainable growth, California State Teachers' Retirement System, https://www.calstrs.com/statement/joint-statement-importance-long-term-sustainable-growth.

[17] Nevin E. Adams, *EBSA Proposal Pours Some Cold Water on ESG Enthusiasm,* Nat'l Ass'n Plan Advisors (June 24, 2020), https://www.napa-net.org/news-info/daily-news/ebsa-proposal-pours-some-cold-water-esg-enthusiasm (focusing on the need for more documentation of ESG decisions and the prohibition on qualified default investment alternatives having ''ESG mandates,'' and also observing that the DOL is now making inquiries about ESG investments of ERISA plans). *See also* Christine Matott, Lawrence Hass, and Josh Sternoff, *DOL Proposes Rule Restricting ESG Investing,* Paul Hastings LLP, https://www.paulhastings.com/publications-items/details/?id=3863ae6f-2334-6428-811c-ff00004cbded (describing the additional burdens placed on ERISA fiduciaries who wish to make direct ESG investments or make ESG investment options available to plan participants and beneficiaries; and Mark Schoeff Jr., *DOL proposal could chill the use of ESG in retirement funds,* Inv. News (June 24, 2020), https://www.investmentnews.com/dol-proposal-esg-retirement-funds-194444 (citing the CEO of the American Retirement Association for the chilling characterization); Warren Rojas, *Death by Paperwork? ESG Investing Probe Hints at Onerous Pile-On,* Bloomberg Benefits & Exec. Comp. News (July 2, 2020) (describing a series of form letters sent to retirement plans that the authors claims ''hint at how the Labor Department may enforce a new requirement that sponsors justify socially conscious investment'').

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predicted that the proposal would discourage ERISA plan fiduciaries from making ESG investments, both for making direct investments and for selecting ESG investment options for self-directed plans.[18] Under the reasoning of the proposal, shareholder activism based on ESG issues, such as encouraging the diversity of corporate boards mentioned above, would also be discouraged.[19] An article in an online journal covering the financial advice business that discussed the proposal was titled, ''A big wince as Trump's DOL presses efforts to erase Obama-era ESG guidance, with tough new rule to curb do-good funds in ERISA accounts; critics cry 'politics.'''[20]

THE DOL ESG PROPOSAL PREMISES

The premises for the DOL ESG Proposal's introduction of severe limitations on the consideration by an ERISA plan fiduciary, who must behave as a ''prudent man acting in a like capacity and familiar with such matters,''[21] rather as an unsophisticated individual investor, of ESG or other non-pecuniary benefits when making investments on behalf of plan participants or beneficiaries or choosing investment alternatives to make available to them are not consistent with prior DOL guidance, with ERISA, with the manner in which fiduciaries prudently select investments on behalf of plan participants and beneficiaries or investment alternatives, or with those participants and beneficiaries' best interests, which is the ERISA lodestar. However, one premise is inconsistent with those limitation, but consistent with prior DOL guidance, ERISA, and the reality of prudent selection of investment options for self-directed plans.

The discussion depends on the extent to which ERISA plan fiduciaries, participants, and beneficiaries may pursue or wish to pursue non-pecuniary investing, particularly ESG investing. Prudent investors, including fund managers, who are interested in knowing the right thing to do, such as with respect to ESG issues, may use such knowledge to pursue one of three investment approaches: (1) the Incorporation approach, i.e., using knowledge of the economic implications of doing the right thing, but not knowledge of the non-pecuniary implications of doing the right thing, for investment decision-making; (2) the Tie-Breaker approach, i.e., using knowledge of the economic implications of doing the right thing and, if there is no economic cost to doing so, also using knowledge of the non-pecuniary implications of doing the right thing, for investment decision-making; and (3) using knowledge of the economic implications of doing the right thing and if there is little economic cost to doing so, also using the knowledge of the non-

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[18] *See, e.g.,* Gary Blachman, Erik Hansen, and Ian Minkin, *DOL Proposes New Fiduciary Guidance for Selection of Socially Responsible Plan Investments,* Ice Miller LLP (July 16, 2020), https://www.icemiller.com/ice-on-fire-insights/publications/dol-proposes-new-fiduciary-guidance-for-selection/ (focusing on the lack of clarity about the new ''economically indistinguishable'' prerequisite for using non-pecuniary factors to choose a fiduciary investment); Lindsay B. Jackson, Daniel R. Kleinman, and Michael B, Richman, *Recent Developments in ERISA Plan Investment Regulation,* Morgan Lewis (July 14, 2020), https://www.morganlewis.com/pubs/recent-developments-in-erisa-plan-investment-regulation (describing initiatives by the DOL and SEC with respect ESG investments); *U.S. Department of Labor proposes new rule that may impact ERISA plans and plan sponsors pursuing ESG,* Linklaters (July 10, 2020), https://www.linklaters.com/en/insights/publications/us-publications/2020/july/department-of-labor-proposes-new-rule-preventing-employee-benefit-plans-from-pursuing-esg-objectives (describing dissonance between DOL approach and the embrace of ESG investments by the market and European authorities); Rebecca Moore, *DOL ESG Proposal Throws a Cloud Over Prior Guidance,* Plan Sponsor (June 30, 2020), https://www.plansponsor.com/in-depth/dol-esg-proposal-throws-cloud-prior-guidance/ (presenting a variety of views including attorneys who spoke of the proposal discouraging but not prohibiting ESG investments and those of ESG investing advocates who argue that the regulation will have little effect because of the superior performance of such investments); *An ESG citing Development — Proposed Regulation on ESG Considerations Under ERISA,* Dechert LLP (June 30, 2020), https://www.dechert.com/knowledge/onpoint/2020/6/an-esgciting-development---proposed-regulation-on-esg-considerat.html (claiming that the proposed regulation may make it more challenging for a Plan fiduciary to conclude that the selection of ESG products meets its fiduciary obligations than under any preceding DOL guidance); and *Proposed Department of Labor Rule Limits Consideration of ESG Factors in Investment Decisions,* Sidley Austin (June 25, 2020), https://www.sidley.com/en/insights/newsupdates/2020/06/department-of-labor-proposes-rule-clarifying-how-esg-investment-factors-should-be-considered (describing the new limitations).

[19] *See* DOL Int. Bull. 2016-01, 81 Fed. Reg. 95,879 (Dec. 29, 2016), and DOL Field Ass't. Bull. 2018-01 (Apr. 23, 2018) (FAB 2018-01) at 4-6, https://www.dol.gov/sites/dolgov/files/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01.pdf (describing the application of ESG principles to investment engagement decisions by ERISA fiduciaries).

[20] Lisa Shidler, *A big wince as Trump' DOL presses efforts to erase Obama-era ESG guidance, with tough new rule to curb do-good funds in ERISA accounts; critics cry 'politics,'* RIABiz (July 1, 2020), https://riabiz.com/a/2020/7/1/a-big-wince-as-trumps-dol-presses-efforts-to-erase-obama-era-esg-guidance-with-tough-new-rule-to-curb-do-good-funds-in-erisa-accounts-critics-cry-politics (describing legal and investment background of proposal, and presenting considerable criticism of the proposal). Although one attorney observed in the article that ''[o]n its face, the DOL has . . . a concern about the manner in which ESG products have been marketed to ERISA plans and a concern that ERISA plan fiduciaries may be making investment decisions based upon non-pecuniary factors rather than focusing solely upon financial factors.'' The issue is whether the proposal is a sensible way of addressing such concern.

[21] ERISA §404(a)(1)(B).

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pecuniary implications of doing the right thing, for investment decision-making.[22]

The Statement in the DOL ESG Proposal Summary that ERISA Fiduciary Investment Decisions be "Based Solely on Financial Considerations" is Inconsistent with the Actual Proposed Regulation, the Prior DOL Proposals, and Reality

The following summary appears at the start of the proposal:

> 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.[23]

Secretary Scalia made the following even clearer statement in a Wall Street Journal column supporting the DOL ESG Proposal, "[ERISA fiduciary] investment decisions must be based solely on whether they enhance retirement savings, regardless of the fiduciary's personal preferences."[24] This sole language is not consistent with the proposal which provides that if two funds are "economically indistinguishable," then ESG factors that are not financial considerations may be used to break the tie.[25] Nor is it consistent with FAB 2018-01, which also permits tie-breaker use, although in a much broader set of circumstances,[26] as to all of its predecessors mentioned in the proposal.[27] Finally, if two investments are economically indistinguishable, by definition one may only choose between the two by looking at a subset of considerations that do not change the fact that the two investment provide the plan with the same economic benefits.

The Description in the DOL ESG Proposal of a Supreme Court holding that ERISA Fiduciary Investment Decisions May Not Consider "Non-pecuniary Benefits" is Inconsistent with the Cited Decision

The DOL ESG Proposal describes the Supreme Court as having unanimously held that the "benefits" to be pursued by ERISA fiduciaries as their "exclusive purpose" do not include a "nonpecuniary benefit"[28] The proposal referred to *Dudenhoeffer*,[29] in which the Court decided that that there is no presumption that ESOP employer stock investments are prudent. In fact, the Supreme Court quote cited therein is part of the following paragraph:

> We cannot accept the claim that underlies this argument, namely, that the content of ERISA's duty of prudence varies depending upon the specific nonpecuniary goal set out in an ERISA plan, such as what petitioners claim is the nonpecuniary goal here. Taken in context, §1104(a)(1)(B)'s reference to "an enterprise of a like character and with like aims" means an enterprise with what the immediately preceding provision calls the "exclusive purpose" to be pursued by all ERISA fiduciaries: "providing benefits to participants and their beneficiaries" while "defraying reasonable expenses of administering the plan." §§1104(a)(1)(A)(i), (ii).

Read in the context of ERISA as a whole, the term "benefits" in the provision just quoted must be understood to refer to the sort of economic benefits (such as retirement income) that trustees who manage investments typically seek to secure for the trust's ben-

[22] *See generally* Feuer, *Ethics, ESG, and ERISA: Ethical-Factor Investing of Savings and Retirement Benefits Part 1,* 47 Comp. Plan. J. No. 12, 212 at 215-16, and 221-22 (Dec. 6, 2019) (Ethics, ESG, and ERISA 1) (discussing ethical-factor investing, i.e., using ethics as a factor to determine whether to acquire, dispose of, or how to exercise ownership rights in an equity or debt interest in a business enterprise, which includes faith-based investing and ESG investing and is a subset of non-pecuniary investing). *See also* Feuer, *Ethics, ESG, and ERISA: Ethical-Factor Investing of Savings and Retirement Benefits Part 2*, 48 Comp. Plan. J. No. 1, 11 (Jan. 3, 2020) (discussing how ERISA plans and their participants and beneficiaries may and may not be able to pursue ethical-factor investing).

[23] *See* DOL ESG Proposal at 39,113 (emphasis added).

[24] Eugene Scalia, *Retirees' Security Trumps Other Social Goals,* Wall St. J. (June 23, 2020), https://www.wsj.com/articles/retirees-security-trumps-other-social-goals-11592953329 (describing and defending the DOL ESG proposal). *But see* Fiona Reynolds, *ESG Is Risk Management, Not an Asset Class,* Wall St. J. (June 29, 2020), https://www.wsj.com/articles/esg-is-risk-management-not-an-asset-class-11593453762 (arguing that the Secretary misunderstands ESG investing which means that ESG factors are used as a financial tool. However, as the proposal observes that is not always the case, which raises the issue in the proposal, how does an ERISA investment fiduciary treat those cases).

[25] *See* DOL ESG Proposal at 39,117-39,118 (the DOL, however, asks for proposals for different ways of resolving such a tie).

[26] FAB 2018-01, Note 19, above, at 2 (emphasis added).

[27] *See* DOL ESG Proposal at 39,114-39,115.

[28] DOL ESG Proposal at 39,114, n. 3.

[29] *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409 (2014).

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eficiaries.[30] The term does not cover nonpecuniary benefits like those supposed to arise from employee ownership of employer stock.[31]

This full quote shows that the Court was making the point that the fiduciary prudence duty does not permit non-pecuniary benefits to adversely affect the economic benefits of the plan participants and beneficiaries. In particular, the plan fiduciary may not sacrifice the plan's economic performance to benefit the plan sponsor.[32] This is consistent with the using non-pecuniary factors as a tie-breaker to decide between two investment choices that would provide a plan with the same economic benefits. In such case, as with the first premise, the only way to distinguish between the two choices is to focus on a nonpecuniary benefit. The Court did not address this situation and would have not disregarded reality to prohibit such behavior.

The DOL ESG Proposal Would Often Prevent an ERISA Fiduciary from Choosing Between Two Investments that Would Give Equal Economic Benefits to the Plan

The DOL ESG Proposal described the prior DOL guidance about what an ERISA fiduciary may do when confronted with two investments that provide equal economic benefits.[33] However, contrary to the proposal's statement that guidance did not "caution that fiduciaries violate ERISA if they accept reduced expected returns or greater risks to secure social, environmental, or other policy goals."[34] Prudent fiduciaries do not focus on individual elements of financial performance, such as risk or return measures, but on the total package which is subsumed in the concept of economic returns. Thus, reduced expected returns with lower risks, or greater risks with greater expected returns, could be acceptable as discussed below. Such combinations could provide the same economic benefits to plans, and thus require fiduciaries choose between the investments using some non-pecuniary benefits, as discussed with the prior premise, but the proposal would prohibit making any choice.

The DOL ESG Proposal correctly paraphrased the preamble of Interpretive Bulletin 94-1[35] when it stated that it held that "when competing investments *serve the plan's economic interests equally well,* plan fiduciaries can use such non-pecuniary considerations as the deciding factor for an investment decision."[36] The DOL therein described what does not serve the plan's economic interests equally well. "[A]n investment will not be prudent if it would provide a plan with a lower expected rate of return than available alternative investments with commensurate degrees of risk or is riskier than alternative available investments with commensurate rates of return."[37] On the other hand, investments that have "commensurate" or "comparable" risk-return profiles serve the plan's economic interests equally well, and thus it is prudent to select the one that is also an economically target investment if it is also otherwise appropriate for the plan. The use of the terms "comparable" and "commensurable" thus appears to recognize that prudent investors will find their economic interests are served equally well by investments with different risk profiles, such as one with a specified risk-return profile and one with a bit more risk and a bit more return, but the bit amount would depend upon the circumstances. This is called the Tie-Breaker approach in the DOL ESG Proposal.[38] The proposal did not discuss the use of the Tie-Breaker approach in any of the later guidance except stating incorrectly that the current guidance limits the Tie-Broker approach to "economically indistinguishable" investments.[39]

However, subsequent guidance, such as Interpretive Bulletin 2015-01 (I.B. 2015-01),[40] added confusion by limiting the Tie-Breaker approach in their explanatory portion to "choosing between investment alternatives that are otherwise equal with respect to return and risk over the appropriate time horizon."[41] which it calls "economically equivalent." The preamble's use of the word "equal" rather than the undefined term "commensurate" raises questions about when the Tie-Breaker approach is applicable. If equality means that there is no statistically significant difference between the expected return and risk over the appropriate horizon of the two investments, then this would simply be a recognition of the uncertainty of such investment performance, and thus a prudent in-

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[30] *Cf.* ERISA§3(2)(A) (defining "employee pension benefit plan" and "pension plan" to mean plans that provide employees with "retirement income" or other "deferral of income").

[31] *Dudenhoeffer*, 573 U.S. 409 at 420-21 (emphasis added).

[32] Similarly, the source of the proposal's statement at DOL ESG Proposal at 39,114 that "ERISA's fiduciary duties as 'the highest known to the law.'" was *Donovan v. Bierwith*, 680 F.2d 263 (2d Cir. 1982) that held that an ERISA plan could not buy employer securities to benefit the employer rather than the plan participants and benefits.

[33] *See* DOL ESG Proposal at 39,114-39,115.

[34] DOL ESG Proposal at 39,114.

[35] DOL Int. Bull. 1994-01, 59 Fed. Reg. 32,606 (June 23, 1994) (I.B. 1994-01) formerly codified in 29 C.F.R. §2509.94-1.

[36] *See* DOL ESG Proposal at 39,114 (emphasis added).

[37] I.B. 1994-01, Note 35, above, at 32,607.

[38] *See* DOL ESG Proposal, at 39,114.

[39] DOL ESG Proposal at 39,117.

[40] DOL Int. Bull. 2015-01, 80 Fed. Reg. 65,135 (Oct. 26, 2015) (I.B. 2015-01).

[41] DOL Int. Bull. 2015-01 at 65,136.

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vestor would treat the investments as serving the plan's economic interests equally well. In concert with the continued use of the commensurate language in the regulation enacted therein,[42] the 2015 bulletin did not substantively change when an ERISA fiduciary may use the Tie-Breaker approach. Again, the prerequisite for the approach is that two investments must *serve the plan's economic interests equally well.*

The DOL ESG Proposal without explanation limited the use of non-pecuniary benefits to what it called "economically indistinguishable" investments.[43] The proposal's preamble requires two such investments to have "the same target risk-return profile or benchmark, the same fee structure, the same performance history, same investment strategy, but a different underlying asset composition," and some other vague conditions.[44] There is no explanation why the fee structure, or any factor other than the risk-reward profile, is relevant to determining whether to use the Tie-Breaker approach.[45] Reference is made to an article assertedly describing such economically indistinguishable investments as unicorns,[46] although the article only uses the term for investments with "identical risk and return attributes."[47]

The only relevant unicorn investment decision, i.e., very rare situation, that plan fiduciaries must make is when they must decide between an investment, such as a mutual fund, that differs from another investment in the same fund, when the former has a greater net expected return because of lower fees. There is then no issue that the fiduciary must choose the investment with the greater net expected return and identical risk. However, this is not the usual situation. Rather, it is the rare exception, The usual rule is that plan fiduciaries must decide among several comparable investments that have the same expected economic value because (1) there is no statistical difference in their respective performance metrics, and/or (2) different performance merits show different superior comparable investments, but the identical expected economic value. The plan fiduciaries may only decide, and do decide, in practice, which investment to make by using the Tie-Breaker approach, i.e., using factors that do not affect the investment's expected financial return. ERISA does not require plan fiduciaries to rely on economic distinctions that do not affect an investment's expected economic return, and thus by definition are, like ESG factors, non-pecuniary factors. Nor does ERISA require such fiduciaries to treat such distinctions incorrectly as economically significant.

The DOL ESG Proposal may also create an unnecessary and perhaps insurmountable barrier to ever using the Tie-Breaker approach. The proposed regulation, mentions, but does not define or discuss the meaning of economically indistinguishable investments.[48] Moreover, a fiduciary, who wishes to use the Tie-Breaker approach, must "document specifically why the investments were determined to be indistinguishable and document why the selected investment was chosen based on the purposes of the plan, diversification of investments, and the interests of plan participants and beneficiaries in receiving benefits from the plan."[49] However, under the proposal's analysis, non-pecuniary benefits have nothing to do with these economic benefits, so it appears that the Tie-Breaker approach may never be used.

The DOL ESG Proposal's Preamble Provides a Sensible Process for Plan Fiduciaries to Prudently Select ESG Options to Make Available to Participants and Beneficiaries

The DOL ESG Proposal begins by following the I.B. 2015-01 approach that permits ERISA fiduciaries of self-directed plan to offer as an investment option a prudently selected, well managed, and properly diversified fund that is a ESG-themed investment fund.[50] Such a fund is defined as a fund that includes one or more environmental, social, and corporate governance-oriented assessments or judgments in their investment mandates or that include these parameters in the fund name.[51] In I.B. 2015-01, the DOL explicitly reaffirmed its 1998 advisory opinion that fiduciaries may consider collateral benefits of an investment alternative, such as those offered by the

[42] DOL Int. Bull. 2015-01 at 65,137, enacting 29 C.F.R. §2509.2015-01.

[43] DOL ESG Proposal at 39,117.

[44] DOL ESG Proposal at 39,117.

[45] *Cf.* 29 C.F.R. §2550.404a-1(b)(2)(ii)(2)(i) (a fiduciary's investment duties requires appropriate consideration of "the risk of loss and the opportunity for gain (or other return) associated with the investment or investment course of action," i.e., the risk-return profile. The regulation does not exclude other factors, but does not mention any of the other factors added by the preamble.

[46] DOL ESG Proposal at 39,1172, n. 22, and 39,122, n. 45.

[47] Max M. Schanzenbach and Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee,* 72 Stan. L. Rev. 381, 409-410 (2020).

[48] DOL ESG Proposal at 39,127, Proposed 29 C.F.R. §2550.404a-1(c)(2).

[49] DOL ESG Proposal at 39,127.

[50] *Cf.* DOL ESG Proposal at 39127, Proposed 29 C.F.R. §2550.404a-1(c)(3) and I.B. 2015-01, Note 40, above at 65,136.

[51] DOL ESG Proposal at 39,118.

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"socially-responsible" Calvert fund (Calvert Opinion).[52]

The DOL declared, in the Calvert Opinion, "A decision to make an investment, or to designate an investment alternative, may not be influenced by non-economic factors unless the investment ultimately chosen for the plan, when judged solely on the basis of its economic value, would be equal to or superior to alternative available investments."[53] The DOL later declared therein that "fiduciaries also must consider expected return on alternative investments with similar risks available to the plan,"[54] which suggests that the alternative available investments are those with similar risk profiles. It would seem more sensible to restrict the economic benefit comparison to alternatives that otherwise satisfy the plan's investment policy and would invest in the same type of assets.

The DOL ESG Proposal limits the I.B. 2015-01 approach, and disregards the Calvert fund advisory opinion. However, the preamble clarifies which alternative available investments to review. namely "to all investment options in similar asset classes or funds in the same category, including potential ESG-themed funds."[55] The proposal presents the Morningstar classifications as an example of such classes.[56] Morningstar has made the following statement in the description of its 122 U.S. classifications cited by the DOL ESG Proposal about how it determines those classifications:

> The Morningstar Category classifications were introduced in 1996 to help investors make meaningful comparisons between mutual funds. Morningstar found that the investment objective listed in a fund's prospectus often did not adequately explain how the fund actually invested. For example, many funds claimed to be seeking "growth," but some of those were investing in established blue-chip companies while others were investing in small-cap companies.
>
> The Morningstar Category classifications solved this problem by breaking portfolios into peer groups based on their holdings. The categories help investors identify the top performing funds, assess potential risk, and build well-diversified portfolios. Morningstar regularly reviews the category structure and the portfolios within each category to ensure that the system meets the needs of investors.[57]

Moreover, Morningstar categorizes all the members of each classification into one of five qualitative ratings on a five-tier scale that summarizes the Morningstar "forward-looking analysis of a fund."[58] Such ratings, and similar ratings by plan financial advisors provide a convenient way of determining a set of commensurable funds. Although on further analysis, a smaller set of such funds may emerge, to which the plan fiduciaries need to apply non-pecuniary factors if the subset all provide the same expected economic benefits.

Thus, under the DOL ESG Proposal, ESG-themed funds are treated like funds with any label that are evaluated by their investment behavior rather than self-described investment policy. It would be a useful addition to the proposed regulation that would recognize what many plan fiduciaries already do, namely apply traditional financial analysis to ESG-themed funds and any funds considered for inclusion in the set of investment options for plan participants and beneficiaries.

The DOL ESG Proposal's Proposed Regulation Would Often Prohibit Plan Fiduciaries from Making Prudently Selected ESG Options Available to Participants and Beneficiaries

However, the DOL ESG Proposal does not stop with identifying a reasonable set of comparable investment option candidates, but instead the preamble and the proposed regulation would require a fiduciary who wishes to offer as an investment alternative a ESG-themed investment fund to use "*only objective risk-return criteria,* such as benchmarks, expense ratios, fund size, long-term investment returns, volatility measures, investment manager investment philosophy and experience, 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 invest-*

[52] I.B. 2015-01, Note 40, above at 65,136-65,137 referring to Advisory Opinion 98-04A, U.S. Dep't Of Labor (May 28, 1998) (Calvert Opinion).

[53] Calvert Opinion at 2.

[54] Calvert Opinion at 3.

[55] *See* DOL ESG Proposal at 39,118.

[56] DOL ESG Proposal at 39,118, n. 23.

[57] *Morningstar Methodology Paper: The Morningstar Category Classifications (for portfolios available for sale in the United States),* Morningstar at 7 (Apr. 29, 2016), https://morningstardirect.morningstar.com/clientcomm/Morningstar_Categories_US_April_2016.pdf.

[58] *Morningstar Investing Glossary: Morningstar Analyst Ratings,* Morningstar https://www.morningstar.com/InvGlossary/morningstar-analyst-rating-for-funds.aspx.

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ment alternatives for the plan . . .''[59] In addition. the fiduciary must document such selection and monitoring.[60] This monitoring applies to existing, as well as new, investment options.[61] Thus, it would preclude a plan from continuing to provide an investment option for which the plan fiduciary monitors criteria other than ''objective risk-return criteria.''

These selection and monitoring requirements establish an unnecessary and perhaps insurmountable barrier to adding many ESG-themed investment options that could be prudently selected. This selection process would preclude a common way an ESG-themed investment fund is constructed and selected. Take a traditional fund or asset class and assemble a subset of the investments that satisfy ESG criteria with risk and return attributes very similar to the original fund, as was described in the Calvert Opinion, in which the fund goal was described as socially responsible investments rather than ESG investments.[62] Similarly, Standard & Poor which created and maintains the S&P 500® Index also created and maintains the S&P 500® ESG Index.[63] The latter could be the basis for an ESG-themed investment. The two indices can be distinguished economically, the former has 500 stocks, whereas the latter had 310 as of June 30, 2020, and the latter would probably have higher management fees, but the ESG index seems to have had consistently higher returns for periods presented within and including the last 10 years, although it is not clear whether the performance differences are statistically significant.[64] In such case, the proposed regulation would not permit the ESG option to be made available, even if the S&P 500® ESG Index would give better economic benefits to its investors, because the fund will be selected and monitored in part by reason of its ESG rankings, which the DOL ESG Proposal does not regard as objective risk-reward criteria.[65]

There are funds that can describe their environmental, social, and corporate governance-oriented assessments or judgment as limited to objective risk-return criteria, such as the criteria set forth in the proposal.[66] Such funds use the Incorporation Approach, in which the investor has no concern whether it is encouraging or discouraging positive ESG behavior. However, if this were always the case for ESG-themed funds, there would be no reason to impose the selection and monitoring requirements set forth. This is not the case for funds, such as Calvert funds discussed above, which emphasize their pursuit of ESG goals, not merely their knowledge of the economic implication of different ESG policies, and thus use the Tie-Breaker approach rather than the Incorporation approach.[67]

The DOL ESG Proposal would permit a plan fiduciary to make a direct investment decision to use either the Incorporation Approach or the Tie-Breaker approach, but would not permit a fiduciary to choose a fund manager, even if the economic benefits are superior to comparable investments, if the fiduciary also takes into account the extent to which the manager is pursuing any non-pecuniary benefits, regardless of the economic benefits the manager would make available. The DOL gives no ERISA basis for imposing such limitation because there is none.

This regulatory requirement cannot be overcome by simply preparing reports about the selection and monitoring of such funds that are restricted to ''objective risk-return criteria,'' while taking credit with plan participants and beneficiaries for choosing funds, such as the Calvert fund, that report substantial reductions

[59] *See* DOL ESG Proposal at 39,127, Proposed 29 C.F.R. §2550.404a-1(c)(3)(i) (emphasis added).

[60] DOL ESG Proposal at 39,127, Proposed 29 C.F.R. §2550.404a-1(c)(3)(ii).

[61] This is consistent with *Tibble v. Edison Int'l*, 135 S. Ct. 1823, 1828 (2015) (holding that an ERISA trustee has a continuing duty — separate and apart from the duty to exercise prudence in selecting investments at the outset — to monitor, and remove imprudent trust investments).

[62] Calvert Opinion, Note 52, above.

[63] Reid Steadman and Daniel Perrone, *The S&P 500® ESG Index: Integrating Environmental, Social, and Governance Values into the Core,* S&P Dow Jones Indices (Apr. 2019), https://www.spglobal.com/_media/documents/the-sp-500-esg-index-integrating-esg-values-into-the-core.pdf.

[64] *The S&P 500® ESG Index,* (June 30, 2020), https://www.spglobal.com/spdji/en/indices/equity/sp-500-esg-index/#overview (Fact Sheet Tab).

[65] DOL ESG Proposal at 39,118, n. 24.

[66] *See, e.g.,* Fiona Reynolds, *ESG Is Risk Management, Not an Asset Class,* Wall St. J. (June 29, 2020), https://www.wsj.com/articles/esg-is-risk-management-not-an-asset-class-11593453762 (responding to Secretary Scalia's June 23, 2020 defense of the proposal by claiming ESG investing means taking into account the economic risks created by ESG factors), and Martin Lipton, *DOL Proposes New Rules Regulating ESG Investments,* Harv. L. Sch. F. Corp. Governance (July 7, 2020), https://corpgov.law.harvard.edu/2020/07/07/dol-proposes-new-rules-regulating-esg-investments/ (asserting ESG investments, social benefits notwithstanding, are fundamentally driven by expected financial return), and Jon Lukomnik, *Comment Letter on Proposed Regulation of ESG Standards in ERISA Plans* (July 21, 2020), https://corpgov.law.harvard.edu/2020/07/21/comment-letter-on-proposed-regulation-of-esg-standards-in-erisa-plans/ (asserting that ESG provides an additional risk control tool to investors above and beyond the risk mitigation available through diversification the rule would ''force plan fiduciaries to turn a blind eye'' to the most proven and effective way to mitigate systematic financial risk of investments, and only to ESG'').

[67] Engagement and Impact Metrics, Calvert, https://www.calvert.com/methodology.php (showing how various Calvert fund portfolios differ in coverage from their benchmark portfolios with respect to enterprise metrics such as carbon emissions or toxic emissions).

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in carbon and toxic emissions[68] which are not objective risk-return-return criteria. Moreover, BlackRock, Vanguard, State Street, Fidelity, and J.P. Morgan Asset Management were all rated very poorly in a 2020 survey of the 75 largest asset managers in the world behavior as responsible investors, with particular emphasis on their behavior with respect to responsible investment governance, climate change, biodiversity, and human and labor rights, attention to climate risk, and loss of biodiversity.[69] Thus, an investor interested in those issues would be more likely to choose a comparable ESG-themed investment from another manager to achieve those goals without sacrificing any economic return, but to achieve better non-pecuniary results.

The ERISA requirement that the plan fiduciary ensure that there is sufficient information about the available investment options for the participant or beneficiary to make an informed investment decision and become responsible for the self-directed investments,[70] is not a reason for imposing such a prohibition on such investment alternatives. This disclosure obligation is not affected by whether the fiduciary selected the option by considering ESG issues or issues of personal comfort with the managers that were not *objective risk-return criteria,* but only the former would fatally taint the inclusion of the ESG-themed fund. Moreover, in the same month of June of 2020 that the DOL ESG Proposal was released, the DOL permitted the inclusion of private equity investments as parts of investment alternatives even though private equity investments generally pose far greater complexity and disclosure challenges than a mutual fund (including an exchange traded fund) that take into account ESG considerations.[71]

In fact, as with the Tie-Breaker documentation requirement, this documentation requirement imposes a substantive barrier with little apparent ERISA basis. There is no reason to change the I.B. 2015-01 approach that all alternative investment options for plan participants, regardless of the asset class or investment policy, whether ESG benefits are considered or not, be prudently selected, well managed, and a part of a properly diversified fund. As with any other investment option, the option should not be chosen or retained if there are any other funds in the set of comparison investments that would provide better economic benefits to the participants or beneficiaries. It may be argued that it is advisable to follow FAB 2018-01 and not include an ESG-themed fund that uses the Tie-Breaker approach, unless a fund with a similar set of investments that does not use the Tie-Breaker approach is also an available investment.[72] However, if there is no such displacement by such fund there would appear no basis for an ERISA exclusion absent a claim that the inclusion of such investment would cause the plan to provide an excessive number of investment options.[73]

Moreover, the proposal is inconsistent with the reason so many individuals want to invest in socially responsible investment funds, which is how Calvert describes its investment theme. These individuals wish to be socially responsible without sacrificing any economic performance,[74] i.e., that they want access to funds with risk-return profiles at least as favorable as

[68] Engagement and Impact Metrics, Calvert.

[69] *See Point of No Returns: A ranking of 75 of the world's largest asset managers' approaches to responsible investment,* Share Action Asset Owners Disclosure Project (Mar. 2020), https://shareaction.org/wp-content/uploads/2020/03/Point-of-no-Returns.pdf (Blackrock and State Street received a D grade, Fidelity, J. P. Morgan, and Vanguard a E grade, and Fidelity an X for taking no action). *See also Global Climate Index 2017: Rating The World's Investors on Climate Related Financial Risk,* Asset Owners Disclosure Project (Apr. 2017), https://aodproject.net/wp-content/uploads/2017/04/AODP-GLOBAL-INDEX-REPORT-2017_FINAL_VIEW.pdf (Blackrock and JP Morgan received a C ranking, State Street and Vanguard a D ranking, and Fidelity a X).

[70] 29 C.F.R. §2550.404c-1(b)(2)(i)(B)(2), §2550.404c-1(b)(2)(i)(B)(3).

[71] DOL Information Letter 06-03-20, https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/information-letters/06-03-2020 (permitting private equity options to be added as components of investment alternatives made available to participants and beneficiaries in self-directed plans, which emphasizes the disclosure and complexity challenges of such options, but nevertheless permitting such investments but requiring the fiduciary to "engage in an objective, thorough, and analytical process that compares the asset allocation fund with appropriate alternative funds that do not include a private equity component"). *See generally Department of Labor Guidance on Private Equity Adds Flexibility for Defined Contribution Plans,* Groom Law Group (June 3, 2020), https://www.groom.com/resources/department-of-labor-guidance-on-private-equity-adds-flexibility-for-defined-contribution-plans/ (explaining the Information Letter from the perspective of the law firm that obtained the letter).

[72] FAB 2018-01, Note 19, above at 3.

[73] *But See* David Blanchett *et al., Bigger Is Better — Defined Contribution Menu Choices With Plan Defaults,* Morningstar Research, https://www.morningstar.com/content/dam/marketing/shared/pdfs/workplace/wp_Bigger_Is_Better_final.pdf (Nov. 12, 2019) (arguing that increasing the number of prudent and diverse core funds from 10 to 30 does not diminish participation rates, but improves (a) the annual risk-adjusted investment performance of those who don't choose the QDIA by about 10 basis points, and (b) the proportion of participants/beneficiaries who choose the QDIA and tend to do better than those who self-direct); and David Blanchett, *Go Wide, Not Deep,* Morningstar Research (May 21, 2019), https://www.morningstar.com/articles/930199/go-wide-not-deep (arguing that the key to a good set of core funds is the quality and variety of risk characteristics of the core funds, rather than their number).

[74] *See, e.g., Fifth Annual Responsible Investing Survey,* Nuveen A Tiaa Company (June 12, 2020), https://www.nuveen.com/en-us/thinking/responsible-investing/fifth-annual-responsible-investing-survey (reporting that 46% of investors invest responsibly to align

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comparable funds without social-responsibility constraints as was permitted under FAB 2018-01.[75] A 2019 survey of employees of sponsors of self-directed plans found that 75% of such employees wanted their investments aligned with their personal values,[76] and 61% said "they would be more likely to contribute, or increase contributions, to their workplace retirement savings plan if they knew their investments were doing social good."[77] The report did not ask about the willingness of such employees to sacrifice economic performance in order to align with their values when each self-selected investments.

The Basic Premise of the Proposal that the Usual Tools by which Careful, Skillful, Prudent and Diligent Fiduciaries Determine the Financial Performance of an Investment or a Participant Investment Option are not Sufficient for ESG Considerations is Inconsistent with Reality

The Proposal refers several times to an excellent 2020 discussion by Professors Max M. Schanzenbach & Robert H. Sitkoff, of ESG investing by pension plan fiduciaries, but did not address the selection of investment options for plan participants and beneficiaries.[78] The professors support ESG investing by ERISA plan fiduciaries to improve the plan's economic performance are skeptical about the extent of the success of such approach in practice, but argue ERISA prohibits those fiduciaries from ever seeking they call collateral benefits, and the proposal calls non-pecuniary benefits, from those investments.[79] Thus, they support the Incorporation Approach, but reject the Tie-Breaker approach. Others have argued that ESG investing generally improves corporate and portfolio economic performance, such as Messrs. Gunnar Friede, Timo Busch, and Alexander Bassen,[80] who, in 2015, aggregated 2000 studies, and Messrs. John Rotonti and Alyce Lomax, who in July of 2020 summarized many positive studies.[81] There seems little disagreement that ESG investing sometimes improves economic performance, but disagreement about the extent to which it does so. A 2014 paper of Drs. Andrij Fetsun and Dirk Söhnholz[82] illustrating the nuances of determining the efficacy of ESG strategies sheds light on this issue. They concluded that using the total score derived from 148 ESG factors had no statistically significant effect on the return or the risk of the portfolio, but using the five, seven, and 10 most significant factors resulted in a statistically significant increase in the return, but no statistically change in the risk.[83] In short, as in most investment decisions, some factors are more relevant than others in determining value.

These conflicting papers illustrate four points. First, the effects of different ESG strategies were determined by comparing their economic performance, which focused on their respective risk-return profiles. This is the same question investment advisors ask when comparing any two potential investments. Second, if the difference in performance is not statistically significant, the investments are considered of equal value to the investor with respect to the performance being measured. Third, the fact that some investments used ESG considerations did not preclude the use of these standard return and risk tools. Fourth, the only relevant feature for the use of the tools was the actual investments, rather than how they were selected, or the motivation for those selections.

Investment advisors can and do the same to compare different investments or different investment funds, namely analyze the expected economic perfor-

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their investments with their values, but 85% will only invest responsibly if this does not cause their financial returns to diminish).

[75] FAB 2018-01, Note 19, above at 3.

[76] *See Retirement reality check,* Natixis at 7 (2019), https://www.im.natixis.com/us/resources/2019-defined-contribution-plan-participant-survey (reporting on attitudes of American workers toward their employer's defined contribution plans and toward their retirement planning).

[77] Retirement reality check at 6.

[78] Schanzenbach and Sitkoff, Note 47, above.

[79] Schanzenbach and Sitkoff, Note 47, above, at 453-54.

[80] Gunnar Friede, Timo Busch, and Alexander Bassen, *ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies,* J. Sustainable Fin. & Investment (Dec. 2015) (finding that roughly 90% of studies find a nonnegative relation between ESG compliance and corporate financial performance, the large majority of studies reports positive findings, and using ESG factors did not adversely impact portfolio performance).

[81] John Rotonti and Alyce Lomax, *Does ESG Investing Produce Better Stock Returns?,* The Motley Fool, https://www.fool.com/investing/2019/05/22/does-esg-investing-produce-better-stock-returns.aspx (finding that, a significant amount of research suggests a positive correlation between companies that do good and companies that do well financially — and by extension, do well for shareholders).

[82] Andrij Fetsun and Dirk Söhnholz, *A Quantitative Approach to Responsible Investment: Using a ESG-Model to improve Equity Portfolios,* SemanticScholar (2014), https://www.semanticscholar.org/paper/A-Quantitative-Approach-to-Responsible-Investment-%3A-Fetsun-S%C3%B6hnholz/8976413a97699f490e31c668cfa7321cfd81ab49 (analyzing whether using different subsets of ESG criteria from sustainalytics would improve equity portfolio for the period from 2004 until 2013).

[83] Andrij Fetsun and Dirk Söhnholz, *A Quantitative Approach to Responsible Investment: Using a ESG-Model to improve Equity Portfolios* at 1-2.

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mance of different investments or investment fund options, rather than how they were selected, the words that were used to described the selection process, or the motivation for those selections.[84] It is customary to recognize that because as is commonly stated in investment brochures, the past is not a guarantee of future performance, to ask as part of this economic performance analysis, whether past performance differences are statistically significant as was done in the above cited studies. If the financial advisor is unable to so analyze the investment or investment fund option, the advisor would recommend against choosing the investment or investment fund option. In particular, given sufficient data one could expect a financial advisor to be able to review any ESG investment that used any of the Incorporation approaches set forth by the Principles for Responsible Investment,[85] which were released in 2006 and continue to be updated.[86]

In many cases, the advisors find no statistically significant difference between the economic performance of two investments or funds in the same asset space that otherwise meet the plan's prudent and diversification requirements. Thus, both serve the plan's economic interests equally well. It is common for prudent fiduciaries to interview representatives of the two funds in such cases. In such cases, the fiduciary must choose either or one some combination of the choices on the basis of any factor, other than one is prohibited, such as racial, religious, or sex discrimination. The deciding factor is often the fiduciaries' greater personal comfort with the representative. There seems no good reason why the fiduciaries should be discouraged or prevented from using ESG preferences or other ethical-factor practices to make such decisions, as the proposal does.

Furthermore, if the economic performance of one investment fund option is superior to the other option to be the plan's qualified default investment alternative (QDIA) for a self-directed plan, that option should be selected as the QDIA. There is no basis presented in the proposal for the proposed regulation prohibition of ESG-themed investments or from being the QDIA or a component of the QDIA.[87] In fact, this decision is contrary to the entire thrust of the proposal, namely that fiduciaries may only make investment choices on the basis of economic performance and must disregard all non-pecuniary concerns except in a very limited set of Tie-Breaker circumstances. In fact, the DOL is letting its hostility to ESG concerns diminish the economic performance of the plan for those participants or beneficiaries who are deferring to their plan's default investment option.

CONCLUSION

None of the premises of the proposal considered above, other than the premise to follow the Morningstar classification approach and judge investment options for plan participants and beneficiaries by comparing the economic benefits of the option with those of options restricted to the same class of assets, are consistent with the terms of ERISA, with the real world of investing, or with the desire of many ERISA plan participants and beneficiaries. More and more American investors are aiming to have their plan benefits include benefits to their environment, society, and the governance of enterprises, as long as no economic benefits are sacrificed, as more and more American investors do each year, and have done throughout the Covid-19 era. Prudent ERISA plan fiduciaries who, in accord with ERISA §404(a)(1)(B), are careful, skillful, prudent, and diligent investment managers, do not focus on the names of investments or investment mandates, or whether there are differences in the various individual financial performance criteria of different investment options. which is almost always the case with options that are of equal economic value to the plan, or its participants and beneficiaries, but on the bottom-line question of whether the options provide different economic returns. If the best option is to have the same economic returns, factors that do not affect those returns, including, but not limited to ESG factors, may and must be used as Tie-Breakers to choose among the options. Thus, the DOL should revise the proposed regulations, and its preamble as follows:

- Define all terms used in the proposed regulation, such as environmental, social, and corporate governance considerations;
- Recognize the primacy of expected economic performance of the available investment options in the selection of a self-directed plan's QDIA, which may be an option which uses environmental, social, and corporate governance considerations;

[84] The ability to make such financial distinctions is not a new development. *See, e.g.,* Alvin D. Lurie, *ETIs: A Scheme for the Rescue of City and Country with Pension Funds,* 5 Cornell J.L. & Pub. Pol'y 315, 351-529 (1996) (arguing that economically targeted investments, which were the subject of I.B. 94-0, like any investments, in practice have sometimes enhanced investment performance, and sometimes diminished it, and should be evaluated on their expected financial performance).

[85] *See generally A Practical Guide to ESG Integration for Equity Investing,* Principles for Responsible Investment (2016), https://www.unpri.org/download?ac=10 (describing how ESG factors may be incorporated into standard investment models).

[86] *See* Ethics, ESG, and ERISA 1, Note 22, above at 216-17.

[87] DOL ESG Proposal at 39,127, Proposed 29 C.F.R. §2550.404a-1(c)(3)(iii).

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- Permit, but not require, plan fiduciaries to use any particular non-pecuniary consideration to make or monitor investments if such consideration is not, like racial, religious, or sex discrimination, prohibited by law, and will not result in (1) an investment that is expected to diminish the plan's expected economic performance, or (2) the displacement of an investment option addressing the same asset class with a superior expected economic performance; and

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- Set forth the duty of plan fiduciaries to review and to monitor the prudence of all their investment decisions, and to maintain records of such actions, while providing that fiduciaries of plans whose number of participants or asset size is below a specified level may be subject to less stringent requirements.

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