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July 30, 2020

VIA *www.regulations.gov*

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

Re: Financial Factors in Selecting Plan Investments Proposed Regulation—Department of Labor RIN 1210-AB95

Patagonia Works ("Patagonia") is submitting this comment with respect to the above-referenced proposed regulation issued by the Department of Labor (the "Department"). The proposed regulation would amend the Department's longstanding position on fiduciary obligations under ERISA section 404(a)(1)(B), with respect to investment selection. The proposed regulation is unnecessary in light of ERISA's existing statutory fiduciary duties and robust participant disclosure regime. Further, it mischaracterizes the nature of environmental, social and governance ("ESG") investing in an intentional effort to chill ESG investing. Not only would the proposed regulation increase the costs to American businesses of maintaining retirement plans, it would needlessly limit the types of investment alternatives available to plan participants.

1. The proposed regulation unnecessarily overregulates ERISA plan fiduciaries and will increase costs for American companies and their employees who participate in retirement plans, in contravention of the Administration's policy of deregulation.

In Executive Order 13771, President Trump demonstrated his commitment to reducing regulation and controlling regulatory costs. Yet, the Department has proposed a regulation that would gratuitously overregulate ERISA plan fiduciaries and likely increase the costs to American businesses of maintaining retirement plans.

At the outset, the proposed regulation is unnecessary because the plain text of ERISA already addresses the Department's stated concerns. In the preamble, the Department made clear that the proposed regulation stems from its concern "that the growing emphasis on ESG investing may be prompting ERISA plan fiduciaries to make investment decisions for purposes distinct from providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plan." However, section 404(a)(1)(A) of the Employee Retirement Income Security Act of 1974 (ERISA) codifies a fiduciary's duty of loyalty as requiring the fiduciary to act *exclusively* for those purposes. Thus, regardless of whether the proposed regulation is finalized, a fiduciary would breach its existing statutory fiduciary duty of loyalty by making

investment decisions for any purposes other than providing benefits and defraying reasonable administrative costs.

In practice, the proposed regulation is unnecessary because many of the added requirements are already addressed by ERISA's fiduciary duty of prudence. Under ERISA section 404(a)(1)(B), a plan fiduciary is required to act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." Thus, regardless of whether the proposed regulation is finalized, a fiduciary faces an existing statutory obligation to carefully consider, weigh, and compare different investment options or courses of action in the context of the plan's overall portfolio, funding objectives, and investment returns.

This proposed regulation is likely to increase costs for American businesses and their employees who participate in retirement plans. In the preamble, the Department expresses concerns regarding the propriety of ESG investments. The text of the proposed regulation provides that an investment alternative with even one ESG assessment or judgment in its investment mandates, or an ESG parameter in its name, is a presumptively imprudent investment.[1] This presumption would increase costs and paperwork for plan fiduciaries who decide to add a prudent ESG fund to a retirement plan, thus increasing costs to the plan and its participants. To reduce litigation risk and audit risk, fiduciaries will likely incur increased expenses when selecting plan investments in order to over-document their selection and monitoring process.

2. The Department fundamentally misrepresents the nature of ESG investing for the thinly veiled political purpose of chilling investment in such companies.

The proposed regulation indicates the Department's confusion, at best, and intentional misrepresentation, at worst, about ESG investing. ESG investing integrates material environmental, social, and/or corporate governance factors into investment decisions *in order to improve long-term financial outcomes*.[2] A number of ESG metrics have been shown to be a strong predictor of earnings risk and return on equity, and they can help investors reduce both risk exposure and volatility.[3] The Department's position that ESG investing sacrifices financial return for nonpecuniary goals is patently false and politically motivated.

Though ESG investing evolved from SRI, it is a distinct investment philosophy. SRI developed in the twentieth century to allow investors to express personal or institutional values by avoiding investments in certain industries that were deemed unethical.[4] Over time, different investment strategies evolved, including "impact investing" and ESG investing. Impact investing involves

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[1] *See* Prop. Reg. 2550.404a-1(c)(3) (permitting plans to use investment alternatives that include ESG assessments or ESG factors in their name only if the fiduciary documents that it selected and monitored the fund based only on objective risk-return).

[2] BlackRock ESG Investment Statement (2020), found at https://www.blackrock.com/us/individual/literature/publication/blk-esg-investment-statement-web.pdf.

[3] SAVITA SUBRAMANIAN ET AL., BANK OF AMERICA MERRILL LYNCH, ESG FROM A TO Z: A GLOBAL PRIMER (2019).

[4] LAUREN CAPLAN ET AL., COMMONFUND INST., FROM SRI TO ESG: THE CHANGING WORLD OF RESPONSIBLE INVESTING (2013).

investing in projects or companies that have beneficial social or environmental impacts.[5] In marked contrast to traditional SRI and impact investing strategies,[6] *ESG investing does not involve making investment decisions for nonpecuniary reasons*. Instead, it focuses on improving investment performance by integrating ESG factors into investment analysis to the extent they are material to investment performance.[7] Thus, while impact investing or SRI might subvert expected investment performance by trading off below-market returns for nonpecuniary benefits *ESG investing seeks to increase returns and minimize both risk and volatility*.[8] If the Department decides to adopt additional regulations in this area (which, as noted above in Section 1, we believe is unnecessary), the Department should ensure that such regulations do not unfairly prejudice ESG investments that produce solid financial results.

3. The proposed regulation will intentionally and unnecessarily restrict participant's investment choices, with the direct result of siphoning funds away from the companies that are putting people and the planet first while also producing strong returns.

The proposed regulation is a beacon of paternalism that restricts participant choices. ESG investments have a legitimate place in many participant-directed savings plans, in addition to a core lineup of well-diversified funds. In some cases, the inclusion of an ESG fund can spur participant interest and engagement in retirement savings. The Department's own regulation on participant-directed funds under ERISA section 404(c) requires that participants must be provided "a broad range of investment alternatives,"[9] consistent with ERISA's fiduciary obligation to diversify plan assets. As noted above, the heightened burden imposed by the proposed regulation will likely discourage plan fiduciaries from offering prudent ESG investments, thereby reducing the number and type of investment alternatives ultimately available to participants. The Department should not foreclose the opportunity to invest in ESG funds altogether, especially because the Department's concerns that were articulated in the proposed regulation should already be adequately addressed by ERISA's requirement that plans

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[5] *Id.*

[6] *See* John H. Langbein & Richard A. Posner, Social Investing and the Law of Trusts, 79 Mich. L. Rev. 72, 73-74 (1980) (defining social investing "to mean the exclusion of securities of certain otherwise attractive companies from an investor's portfolio because the companies are judged to be socially irresponsible, and including the securities of certain otherwise unattractive companies because they are judged to be behaving in a socially laudable way" and noting that these methods subordinate profit maximization to other goals); GOLDMAN SACHS, ESG AND IMPACT INVESTING, https://www.gsam.com/content/gsam/us/en/institutions/strategies/explore-by-solution/esg-and-impact-investing.html#tabpanel_f9a0=dGFicGFuZWxfZjlhMF8xL3B1YmxpYy8x (noting that impact investments "seek to preserve capital but may sacrifice some financial return objectives to achieve impact").

[7] LAUREN CAPLAN ET AL., COMMONFUND INST., FROM SRI TO ESG: THE CHANGING WORLD OF RESPONSIBLE INVESTING (2013). *See also* Susan N. Gary, Best Interests in the Long Term: Fiduciary Duties and ESG Integration, 90 U. Colo. L. Rev. 731, 743 (2019) ("Financial analysts use ESG integration to improve stock selection because the ESG factors can identify potential opportunities and risks.").

[8] Susan N. Gary, Best Interests in the Long Term: Fiduciary Duties and ESG Integration, 90 U. Colo. L. Rev. 731, 746-47 (2019).

[9] 29 CFR §2550.404c-1(b)(1)(ii).

provide adequate and complete disclosures to enable participants to make informed investment decisions.[10]

The Department's mischaracterization of ESG investing reveals a thinly veiled political bias against companies that embrace social and environmental considerations. It compels plan fiduciaries to restrict a plan's investment options to companies in traditional fields such as banking and extractive industries. These companies are conveniently aligned with Trump Administration supporters and donors. If the Department decides to regulate in this area, it should ensure that such regulations do not blatantly favor the financial interests of Trump Administration donors and cronies at the expense of plan participants.

Conclusion

The Department should not finalize the proposed regulation in its current form, as it is unnecessary and will increase the costs to American business of maintaining retirement plans. Even if the Department's concerns about ESG investing were justified, ERISA's statutory provisions adequately protect participant retirement assets from investments that subvert expected investment performance for nonpecuniary benefits. Additionally, ERISA already provides a robust scheme for participant disclosures that enables individuals to make fully informed investment decisions. A needless regulation that imposes such burdens contravenes the Administration's policy of deregulation and will pointlessly increase business costs. Further, the regulation exposes a political bias in favor of Trump Administration supporters in a transparent manner that both undermines the credibility of the Department and sacrifices the best interests of plan participants.

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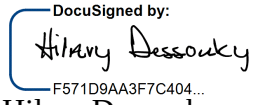
Thank you for the opportunity to share our comments. We welcome the chance to discuss these issues further and request the opportunity to do so at a public hearing.

Respectfully submitted,



Hilary Dessouky

General Counsel

[10] *See* 29 CFR §2550.404a-5(d) (requiring fiduciaries to disclose for each investment alternative performance data, expenses and fees, benchmarks, principal strategies, objectives and goals, and more).