July 29, 2020

Office of Regulations and Interpretations

US Department of Labor

Room N-5655

200 Constitution Avenue NW

Washington, DC 20210

RE: **Proposed rule on Financial Factors in Selecting Plan Investments (RIN 1210-AB95)**

To whom it may concern:

We write as members of the Intentional Endowments Network (IEN) Fiduciary Duty Working Group who are experienced investment and legal professionals to alert the Department that the proposed rule, "Financial Factors in Selecting Plan Investments" (RIN 1210-AB95) (the "Proposal"), is based upon outdated information and an incomplete ERISA fiduciary duty analysis.

The IEN is not merely concerned about application of the Proposal to pension plans associated with its member endowments, foundations and the academic institutions they serve. We also see the Proposal as having potential spillover effects on management of nonprofit endowment and foundation assets, as the same basic standards apply to charities as are used in making pension fund investments.[1]

Extension of Comment Period

We request that the comment period be extended from 30 to 90 days. The 30-day comment period does not allow sufficient time for preparation of comprehensive responses to such a complex, lengthy and impactful regulatory action. The shortened comment period is also out of sync with the longer response windows used for proposed regulatory changes of similar magnitude (e,g., the 2019 Proposed Rule on Joint Employer Status Under the Fair Labor Standards Act had a 60-day

[1] The Prefatory Note to the Uniform Prudent Management of Institutional Funds Act (UPMIFA) states, "UPMIFA reflects the fact that standards for managing and investing institutional funds are and should be the same regardless of whether a charitable organization is organized as a trust, a nonprofit corporation, or some other entity. See Bevis Longstreth, Modern Investment Management and the Prudent Man Rule 7 (1986) (stating "[t]he modern paradigm of prudence applies to all fiduciaries who are subject to some version of the prudent man rule, whether under ERISA, the private foundation provisions of the Code, UMIFA, other state statutes, or the common law.")" https://www.uniformlaws.org/viewdocument/final-act-with-comments-71?CommunityKey=043b9067-bc2c-46b7-8436-07c9054064a3&tab=librarydocuments (visited July 21, 2020).

comment period).[2] Additionally, colleges and universities, who have aggregate retirement plan assets totaling over $900B in AUM, are consumed with the many challenges of serving their students in the time of the Covid pandemic and cannot currently devote the attention to this rule change that it deserves.

Arbitrary and Capricious

First, the Proposal uses outdated performance and cost data; misrepresents current practices used by qualified economic professionals for application of generally accepted investment theories to evaluation of environmental, social and corporate governance (ESG) economic risks and opportunities; and lumps vastly different investment strategies together (socially responsible investing, sustainable and responsible investing, impact investing, economically targeted investing) without distinguishing them from integration of financially material ESG considerations into investment analysis.

The Proposal not only completely fails to consider current facts and logically connect its provisions to real world practices, but is also internally inconsistent and confusing. It would only muddy the understanding of how fiduciary duties apply to integration of material ESG factors into investor due diligence.

According to a report by Morningstar, from 2014-2019, sustainable funds did well in both up and down markets relative to conventional peers. "When markets were flat (2015) or down (2018), the returns of 57% and 63% of sustainable funds placed in the top half of their categories. When markets were up in 2016, 2017, and 2019, the returns of 55%, 54%, and 65% of sustainable funds placed in the top half of their categories."-[3]

Further, a 2019 report by Bank of America's global research arm, stated that "U.S. companies with high (top quintile) ESG rankings in the S&P 500 index have outperformed their counterparts with lower (bottom quintile) ESG rankings by at least 3% every year for the past five years.[4]

Flawed ERISA Fiduciary Duty Analysis

The Proposal also provides no analysis of the fiduciary duty of impartiality and how it relates to integration of financially material ESG factors into investment due diligence. This is a fatal flaw, as the Proposal would discourage, if not preclude, ERISA fiduciaries from considering risks and opportunities that are of particular financial materiality to younger plan participants with long-term investment horizons, apparently discounting their financial interests in favor of participants with short-term horizons.[5]

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[2] https://www.regulations.gov/document?D=WHD-2019-0003-0001 (visited July 21, 2020).

[3] "US ESG Funds Outperformed Conventional Funds in 2019", Morningstar, 2020

[4] "ESG from A to Z", Bank of America Global Research, November 2019

[5] While the Proposal recognizes that fiduciaries should evaluate risk and return "based on appropriate investment horizons," it undertakes no analysis of issues from the perspective of plan

The US Supreme Court recognized in *Varity v. Howe,* 516 U.S. 489 (1996), that the duty of impartiality applies to fiduciaries under ERISA. The Supreme Court stated, "The common law of trusts recognizes the need to preserve assets to satisfy future, as well as present, claims and requires a trustee to take impartial account of the interests of all beneficiaries. See Restatement (Second) of Trusts § 183 (discussing duty of impartiality); *id.,* § 232 (same)." *Varity* at 514.[6]

Application of the duty of impartiality to ERISA plan participants with different investment time horizons and risk tolerances is highly relevant to consideration of financially material ESG considerations. In a July 2020 United States Government Accountability Office (GAO) Report on *Public Companies: Disclosure of Environmental, Social and Governance Factors and Options to Enhance Them*, the GAO summarized results of its recent investor survey in regard to application of time horizons to ESG analysis. The GAO noted, "Institutional investors with whom we spoke generally agreed that ESG issues can have a substantial effect on a company's long-term financial performance. All seven private asset managers and representatives at five of seven public pension funds said they seek ESG information to enhance their understanding of risks that could affect companies' value over time." GAO-20-530, at page 9.[7]

In fact, adoption of a long-horizon investment strategy has been found to be associated with better performance. In a study of 615 large- and mid-cap US publicly listed companies' performance from 2001-2015, the McKinsey Global Institute reported that, "Long-term companies exhibit stronger financial performance over time. On average, their market capitalization grew $7 billion more than that of other firms between 2001 and 2014. Their total return to shareholders was also superior, with a 50 percent greater likelihood that they would be top decile or top quartile by 2014." *Measuring the Economic Impact of Short-Termism* (February 2017), page two.[8]

Another study of publicly traded companies in the MSCI All Country World Index done by Focusing Capital on the Long Term also identified ESG factors as being associated with better performance of companies over the long-term. *Predicting Long-Term Success for Corporations and Investors Worldwide,* FCLT Global (September 2019), pages seven to eight.[9]

Unfortunately, the Proposal fails to consider this line of research and how a plan participant's time frame might influence the suitability of investment approaches that consider material ESG factors as part of the due diligence process. In fact, the Proposal would preclude plan participants from having access to prudently managed long-term investment default options that might be determined through a complete fiduciary duty analysis (which does not omit the duty of impartiality) to best fit their risk profile and investment horizon. As a result, <u>the Proposal is likely to reduce the future financial value of retirement accounts</u> for many ERISA participants with a long-term horizon, nor does it recognize that many ESG factors present greater pecuniary materiality over the long term.

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6 https://supreme.justia.com/cases/federal/us/516/489/ (visited July 21, 2020).

7 https://www.gao.gov/products/GAO-20-530 (visited July 21, 2020).

8 https://www.fcltglobal.org/resource/measuring-the-economic-impact-of-short-termism/ (visited July 21, 2020).

9 https://www.fcltglobal.org/resource/predicting-long-term-success-for-corporations-and-investors-worldwide/ (visited July 21, 2020).

plan participants and unnecessarily expose them to risks by discouraging fiduciaries from considering them.

This arbitrary endorsement of outdated investment practices, while excluding recently improved investment theories that have been found to improve investment results and been adopted by a large (and growing) segment of mainstream investment firms with $40 trillion under management,[10] also runs counter to established trust law principles. The *Restatement of Trusts (Third),* a leading authority on investor fiduciary law, was amended in 1992 in response to decades of debate over acceptance of Modern Portfolio Theory (reflecting rejection of earlier practices which excluded public equities from being an allowed trust fund investments), to confirm that fiduciary practices cannot remain static. The *Restatement (Third)* confirms, "Trust investment law should reflect and accommodate current knowledge and concepts. It should also avoid repeating the mistake of freezing its rules against future learning and developments."[11] <u>The Proposal violates this fundamental trust law principle that fiduciary duty is a dynamic concept</u> by attempting to ignore current knowledge and accepted investment concepts while seeking to freeze interpretation of fiduciary duties against recent learning and developments.

Under a complete ERISA fiduciary duty legal analysis, the Proposal is inconsistent with ERISA fiduciary duties. It extends beyond the powers given to the Department of Labor by Congress.

Conclusion

The Proposal is likely to have the perverse effect of dissuading fiduciaries, even against their better judgment, from offering options for their plans that consider financially material ESG criteria in addition to more traditional financial criteria. As a result, it will unfairly, and harmfully, limit use of investments which improve diversity and risk management and best meet the long-term investment time horizon requirements of younger participants. It will likely place many participants in retirement fund investments that are more risky and less profitable than prudent alternatives which take financially material ESG factors into consideration. As an organization of academic institutions focused on serving the needs of young people and educating them to address future personal and societal challenges, we see the Proposal as especially damaging, counterproductive and ill advised.

We respectfully request that the Proposal be withdrawn. Thank you for your consideration of these comments.

Sincerely,

Georges Dyer, Executive Director

Alice DonnaSelva, Managing Director

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[10] *ESG Data Integration by Asset Managers: Targeting Alpha, Fiduciary Duty & Portfolio Risk Analysis* (June 2020), Opimas; http://www.opimas.com/research/570/detail/ (visited July 21, 2020).
[11] RESTATEMENT (THIRD) OF TRUSTS ch. 17, intro. note (AM. LAW INT. 1992).