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

Re: RIN 1210-AB95, Financial Factors in Selecting Plan Investments

To Whom it May Concern,

The National Employment Law Project ("NELP") writes in strong opposition to the Department of Labor Employee Benefits Security Administration's ("DOL's) proposed rule, "Financial Factors in Selecting Plan Investments", Regulatory Identifier Number (RIN) number 1210-AB95. NELP is a non-profit research and policy organization that for over 50 years has advocated for the employment and labor rights of workers. NELP's goals are to promote economic security, dismantle structural racism, and promote worker power in our society. NELP's constituents include the millions of workers and their families in the U.S. who are the beneficiaries of ERISA pension plans. These workers count on every dollar of their retirement savings to make ends meet when they retire. NELP is concerned that this rule, if finalized, would make it nearly impossible for ERISA plan fiduciaries to consider environmental, social and governance (ESG) factors in making investment decisions and ESG investing opportunities. It will have the effect of restricting the available set of funds as investment options. By prohibiting their use as Qualified Default Investment Alternative funds[1] (QDIA funds) the DOL proposal will force ERISA fiduciaries who tend workers' retirement funds into options with potentially inferior risk-return profiles. Collectively, these proposed changes will, if anything, adversely impact the returns of ERISA pension plans and thus harm worker beneficiaries by resulting in lower retirement income for American workers.

The DOL 's proposals are "unsupported by substantial evidence" and "arbitrary and capricious" in violation of the Administrative Procedure Act. Moreover, the proposal could discourage companies from making much needed changes in their treatment of workers by removing social criteria such as a company's policies on diversity, health and safety and worker compensation from investment decisions, *even when those criteria contribute to increased returns*. By restricting ESG investing, the DOL's proposal would undermine a powerful tool that leverages trillions of dollars a year to drive positive social change lift up best practices of law-abiding employers and hold non-compliant companies accountable. NELP urges the DOL to withdraw the proposal in its entirety.

[1] A 401(k) QDIA () is a default investment used when money is contributed to an employee's 401(k) account, but the employee has not made their investment election. The plan fiduciary, typically the business owner or 401(k) plan manage, is responsible for selecting the QDIA.

1. **ESG considerations are financially material to investment decisions, and ESG investing has provided returns at least comparable to conventional investments, having recently outperformed conventional investments.**

The ultimate purpose of ERISA is to protect workers' retirement by, among other things, maximizing retirement savings. To that end, ERISA fiduciaries owe duties of care and loyalty to their worker beneficiaries.[2] The underlying premise of the proposed DOL regulations is that ERISA fiduciaries compromise those duties if they consider ESG risks and opportunities when choosing their investments, because ESG considerations are not financially material, and in fact are financially inferior. The NPRM states: "The Department is concerned…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."[3]

But there is little evidence that plans sacrifice returns when considering ESG risks and opportunities and investing in ESG funds. A Government Accountability Office (GAO) report reviewed 5 years of studies and reports and concluded, "The vast majority (88 percent) of scenarios in studies we reviewed…reported finding a neutral or positive relationship between the use of ESG information in investment and management returns in comparison to otherwise similar investments".[4] A large meta- study that compared the relationship of ESG factors to corporate financial performance found that ESG investing "pays financially," and that the positive impact of ESG factors on corporate financial performance continues over time.[5] Recent studies by Morningstar[6], and BlackRock[7] show the same. In fact, ESG investments can be *less* risky during major market upheavals, as demonstrated by the superior performance of ESG investments vs. conventional investments during the initial market reaction to the COVID 19 pandemic.[8]

Moreover, plan fiduciaries understand that ESG considerations can and often do affect a company's financial performance. A July 2020 GAO report noted: "Most institutional investors GAO interviewed (12 of 14) said they seek information on environmental, social, and governance (ESG) issues to better understand risks that could affect company financial performance over time. These investors added that they use ESG disclosures to monitor companies' management of ESG risks, … or make stock purchasing decisions."[9] In fact, there is substantial evidence that human rights issues, which encompass the workers' rights and diversity issues that

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[2] ERISA Section 404(a)(i) (A)
[3] 85 Fed. Reg. 39113 at 39116 (June 30, 2020).
[4] Government Accountability Office, Retirement Plan Investing: Clearer Information on Consideration of Environmental, Social, and Governance Factors Would be Helpful (May 2018), 7-8. Available at https://www.gao.gov/assets/700/691930.pdf.
[5] Friede, Gunnar and Busch, Timo and Bassen, Alexander, ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies, Journal of Sustainable Finance & Investment, Volume 5, Issue 4 (October 2015) at 210, 212, 217 (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2699610).
[6] https://www.morningstar.com/articles/973590/us-esg-funds-outperformed-conventional-funds-in-2019.
[7] Hugh Leask, Hedgeweek, New BlackRock research points to ESG resilience during coronavirus downturn, May 15, 2020, https://www.hedgeweek.com/2020/05/19/285741/new-blackrock-research-points-esg-resilience-during-coronavirus-downturn.
[8] See S&P Global Market Intelligence, Major ESG investment funds outperforming S&P 500 during COVID-19, April 13, 2020, https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/major-esg-investment-funds-outperforming-s-p-500-during-covid-19-57965103: Ola Mahmoud and Julia Meyer, "Sustainability in the Time of Uncertainty", May 2020 at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3597700, and, Alex Cheema-Fox, Bridget R. LaPerla, George Serafeim and Hui (Stacie) Wang, 'Corporate Resilience and Response During COVID-19", July 2020 at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3578167 .
[9] Government Accountability Office, Public Companies: Disclosure of Environmental, Social, and Governance Factors and Options to Enhance Them (July 2020) at 9-11. Available at https://www.gao.gov/products/gao-20-530.

NELP is most concerned with, pose financial impacts, opportunities and risks to companies -- all of which affect investor return. For example, McKinsey & Company has consistently found that companies with higher rates of racial and gender diversity outperform their peers, concluding most recently in 2020 that companies in the top quartile for gender diversity on executive teams were 25 percent more likely to have above-average profitability than companies in the third quartile.[10] In addition, studies of employment conditions found that firms that treat their workforce poorly suffer a host of negative consequences, including: weaker access to human capital; higher turnover (and associated financial costs of such instability), and decreased trust and innovation. [11] For example, a 2018 report found that companies with poor human rights practices face risks, including workplace injuries and illnesses, high turnover, and a greater chance of facing employee-related litigation.[12] Recently, reports of poor working conditions in a retailer's factories have led to significant decreases in a company's stock prices.[13] Thus, not only do ESG considerations affect a company's financial performance, using those considerations as part of an investment strategy does not harm, and usually positively affects, investment returns. By making it nearly impossible to consider ESG factors or invest in ESG guided funds, the DOL could be forcing fiduciaries into choosing potentially lower producing investments, resulting in lower retirement savings for worker beneficiaries in direct contravention of ERISA's central concern.

2. **Instead of discouraging consideration of ESG factors, the DOL should conclude that ERISA fiduciaries have an affirmative duty to consider them.**

ERISA fiduciaries owe their worker beneficiaries a duty of prudence which is defined as acting "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man [sic] 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."[14] Thus courts "focus not only on the merits of the transaction, but also on the thoroughness of the investigation into the merits of the transaction." *Howard v. Shay*, 100 F.3d 1484, 1488 (9th Cir. 1996). Given the studies and reports cited above which demonstrate the materiality of ESG considerations, and in many cases the often-superior returns of ESG guided investments, DOL should instead inform ERISA fiduciaries that they have an affirmative duty to investigate and consider ESG factors. Indeed, according to a recent study, 59% of institutional investors in North America have already adopted this view, reporting that they considered ESG considerations as part of their fiduciary duty.[15]

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[10] Vivian Hunt, Sundiatu Dixon-Fyle, Sara Prince, Kevin Dolan, McKinsey & Company, Diversity Wins: How Inclusion Matters, May 2020 (https://www.mckinsey.com/featured-insights/diversity-and-inclusion/diversity-wins-how-inclusion-matters).

[11] Casey O'Connor, Sarah Labowitz, NYU Stern Center for Business and Human Rights, Putting the "S" in ESG: Measuring Human Rights Performance for Investors, March 2017 (https://www.stern.nyu.edu/experience-stern/global/putting-s-esg-measuring-human-rights-performance-investors).

[12] Dr. Başak Bağlayan, Ingrid Landau, Marisa McVey & Kebene Wodajo, Good Business: The Economic Case for Protecting Human Rights, December 2018 at 18, https://www.researchgate.net/publication/329828724_Good_Business_The_Economic_Case_for_Protecting_Human_Rights.

[13] Shalini Nagarajan, "Boohoo stock tumbles 30%, wiping $1.25 billion off its market value, after an explosive report into working conditions at one of its factories," Business Insider, July 7, 2020. Available at https://markets.businessinsider.com/news/stocks/boohoo-stock-price-reaction-criticism-over-low-factory-workerwages-2020-7-1029371727#.

[14] § 404(a)(1)(B) of ERISA.

[15] State Street Global Advisors, Into the Mainstream: ESG at the Tipping Point (November 2019) at 2and 8, https://www.ssga.com/library-content/pdfs/insights/into-the-mainstream.pdf.and 8.

3. **The DOL should not abandon the existing interpretation of the "tie breaker" rule which allows for ESG factors to be considered for non-pecuniary reasons.**

For many years the DOL has allowed ERISA fiduciaries to consider ESG factors, even if they cannot be proven to be economically material, as "tie-breakers" in choosing among investments that have comparable risks/returns. The DOL's proposed rule would abandon that interpretation and instead allow fiduciaries to consider ESG factors only if they can demonstrate that the ESG factors under consideration would improve forecasted financial performance.

The proposed rule prohibits a fiduciary from investing in an ESG opportunity unless the opportunity is identical in all respects with an alternative opportunity, including choice of benchmark, fee structure, performance history, investment strategy and underlying asset composition.[16] It describes these as "economically indistinguishable" investments.[17] This is accurate insofar as these investments would have to effectively be the same investment. But no two truly distinct investment opportunities are identical in all ways. Stocks of different companies in the same industry, and same region with the same customer base will inevitably have different, economically relevant characteristics, ranging from product mix, to capital structure, to governance, to workforce, to liquidity and so on. For that reason, the proposed rule's new tie-breaker test is one that can almost never be satisfied. Indeed, the DOL signals to fiduciaries that this is true when it observes that "true ties rarely, if ever, occur".[18] In addition, any fiduciary who uses the tie breaker test under this rule to select an ESG investment must formally document why the investment was determined to be economically indistinguishable, an intentionally burdensome procedure designed to discourage fiduciaries. Collectively these changes impose enormous burdens on fiduciaries' decisions to consider ESG factors or choose ESG investments, and therefore deter fiduciaries from considering them. The DOL should withdraw the proposal and retain the traditional tie-breaker test.

4. **The DOL should withdraw the portion of the proposed rule that prohibits the use of ESG investments as QDIA's.**

Even if a fiduciary could demonstrate, despite the obstacles the proposed rule would create, that a ESG investment is superior in terms of risk/financial performance, the proposed rule would arbitrarily prohibit ESG investments use as a Qualified Default Investment Alternative in a defined contribution plan.[19] The DOL states that it "is inappropriate for participants to be defaulted to a retirement savings fund with other objectives without their consent."[20] But this prohibition will have the impact of forcing, in certain circumstances, fiduciaries to select as QDIA's investments those they know are financially inferior to ESG investments, contrary to ERISA's "overall concern"[21] of maximizing retirement savings. The DOL seems to justify this prohibition by stating "in the QDIA context a fiduciary's decision to favor a particular environmental, social, corporate governance, or similarly oriented investment preference—and especially a decision to favor the fiduciary's own personal policy preferences—would raise questions about the fiduciary's compliance with ERISA's duty of loyalty."[22] But if there is a duty of loyalty concern, then the existing framework of the traditional tie-breaker test is already in place to protect the interests of the plan

16 85 Fed. Reg. 39113 at 39117.
17 Id.
18 Id.
19 See 29 C.F.R. Section 2550.404c-5 for current regulations regarding QDIAs.
20 85 Fed. Reg. at 39119.
21 Id.
22 Id.

participants and beneficiaries. In applying this test, fiduciaries are already required to exercise ERISA's high standards of due care, skill, prudence, and diligence without conflicts of interest. Once the substantive requirements of ERISA have been satisfied, there is no ERISA-based justification for the DOL to single out a class of investments, those involving ESG considerations, for this prohibition. And if the DOL finalizes its proposed changes to this test, why should a fiduciary who manages to meet its nearly impossible standards be prohibited from selecting the ESG Investment as a QDIA? Indeed, as discussed above, it is more consistent with ERISA for the DOL to conclude that only those investment options that consider ESG risks and opportunities be considered for QDIA status.

Conclusion

The proposal regulation, if finalized, will undermine the ability of ERISA fiduciaries to act in the long-term best interest of their worker beneficiaries. As such, NELP urges the withdrawal of the proposed regulation.

Sincerely,

Judith M. Conti
Government Affairs Director