INTERNATIONAL UNION OF PAINTERS AND ALLIED TRADES, AFL-CIO

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July 30, 2020

Mr. Jason A. DeWitt
Office of Regulations and Interpretation
Employee Benefits Security Administration, Room N-5655
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, D.C. 20210

Re: Notice of Proposed Rulemaking: Financial Factors in Selecting Plan Investments - Proposed Regulation RIN 1210-AB95

Dear Mr. DeWitt:

The International Union of Painters and Allied Trades ("IUPAT") submits these comments on the proposed rule regarding "Financial Factors in Selecting Plan Investments" that would amend the Investments Duties regulation under Title I of ERISA. A principal focus of IUPAT and its affiliates is to provide retirement security for our members and their families.

IUPAT has over 100,000 active members, almost all of whom participate in Taft-Hartley defined benefit pension plans, and many more retired and former members who enjoy retirement benefits provided by those plans. IUPAT itself, along with contributing employers, sponsors the Painters and Allied Trades Industry Pension Plan ("the IUPAT Industry Plan"), a nationwide plan with over $3 billion in assets that provides retirement benefits to over 30,000 current beneficiaries and has approximately 38,000 active participants who are earning retirement benefits based on employer contributions made for every hour of their work. Other IUPAT members are covered by local Taft-Hartley plans sponsored by local IUPAT affiliates and their signatory employers.

We make three main points. First, except for the additional guidance the proposed rule provides to individual account plans, it does not materially change the prior guidance provided by the Department. Any final rule should make clear that, with respect to the investment duties of fiduciaries of defined benefit plans, the rule is not intended to, and does not change, the standards previously articulated by the Department. Absent such a clear statement, the rule likely will dissuade some fiduciaries from making sound investments they otherwise would make out of fear such investments will bring regulatory scrutiny and the resulting diversion of fund time and resources to address that scrutiny. This is due to the perception, already apparent in public reaction to the proposed rule (*see infra* at 2), that consideration of ESG factors is disfavored by the Department and, therefore, should be avoided. The government simply should not be in the business of favoring certain investment strategies over others. That should be left to the wisdom of the market and the sound judgment of fiduciaries and their advisors.

Second, the proposed rule appears to treat additional employer contributions resulting from investments that create work for fund participants as a non-pecuniary factor. That is dead wrong. Additional contributions result in a net financial benefit to defined benefit funds because every dollar contributed increases assets more than liabilities. Any final rule should make clear that any factor that has the potential of affecting the ability of the fund to pay benefits, including increased contributions flowing from increased work for participants, is a pecuniary factor.

Third, the commentary preceding the proposed rule minimizes the number of situations in which alternative investments should be fairly judged to be economically indistinguishable. This commentary confuses the fact that alternative investments may be "different" with whether, looking forward, they are materially distinguishable in terms of anticipated risk and return. In the real world, it is incredibly difficult for any investor to reliably predict which of several alternative investments in similar asset classes will perform better in the long run. If it were otherwise, virtually all capital would flow to the "better" (greater return with less risk) investments. But, since no investor has a crystal ball, equally informed and prudent investors must pick among many different investments, each of which has a relatively equal chance of being the best choice. Thus, in the most pertinent sense – predicting which of those investment alternatives is likely to be the best – those choices are indistinguishable.

I. THE FINAL RULE SHOULD MAKE CLEAR THAT IT DOES NOT MATERIALLY CHANGE THE EXISTING STANDARD FOR THE PERMISSIBLE CONSIDERATION OF ESG FACTORS

The Background and Purpose section of the supplementary information provided with the proposed rule repeatedly emphasizes that "the Department's longstanding and consistent position, reiterated in multiple forms of sub-regulatory guidance, is that plan fiduciaries when making decisions on investments and investment courses of action must be focused solely on the plan's financial returns." *See* 85 Fed. Reg. No. 126 at 39114 (June 30, 2020). *See also id*. at 39115 (discussing the advice provided in IB 2015–01 and clarified in FAB 2018–01 that consideration of ESG factors is permitted if the decision is based on pecuniary considerations); 39116 ("the Department intends, by this proposal, to *reiterate and codify long-established principles* of fiduciary standards for selecting and monitoring investments"); 39117 (explaining that most provisions merely "clarify" or "expand" on the existing regulatory language). Nonetheless, the clear public perception is that the rule is designed to discourage social investing. *See EBSA Proposal Pours Some Cold Water on ESG Enthusiasm*, https://www.asppa.org/news/ebsa-proposal-pours-some-cold-water-esg-enthusiasm; Bogner, Ira; Hirschhorn, Russell; Safra, Seth; Weinstein, Steven; Scoll, Adam and Hansen, Kyle; *Department of Labor Proposal Would Curtail ESG Investing*, https://www.erisapracticecenter.com/2020/07/department-of-labor-proposal-would curtail-esg-investing; Powell, Robert, *Labor Dept. Putting the Kibosh on ESG Funds in Retirement Accounts*, https://www.thestreet.com/retirement-daily/saving-investing-for-retirement/labor-dept-putting-the-kibosh-on-esg-funds-in-retirement-accounts-wUWDm3dL4kyHMj5CIJJBbQ.[1]

[1] This perception may stem in part from the proposal's commentary on the "upward trend in the use of ESG among institutional asset managers" and "an increase in asset flows into ESG funds," followed by the

ERISA does not prohibit any specific class of investments. It simply requires that a fiduciary (1) act solely in the interests of the beneficiaries and for the exclusive purpose of providing benefits and defraying reasonable administrative expenses, (2) discharge their duties in accordance with the prudent person standard, (3) diversify investments to minimize the risk of large losses, and (4) observe the lawful provisions of the plan's governing documents. *See* 29 U.S.C § 1104(a)(1).

Accordingly, the final rule should make clear that it cannot, and is not intended to, change a standard set by the statute itself. To quote Coach Tomlin, "the standard is the standard." Just as the level of play should not change when substitutes replace starters, the fiduciary duty of trustees does not change when different personnel manage the Department of Labor.

II. <u>THE DEFINITION OF PECUNIARY FACTORS MUST INCLUDE ALL FACTORS THAT AFFECT THE FINANCIAL HEALTH OF A PENSION FUND, INCLUDING ADDITIONAL EMPLOYER CONTRIBUTIONS CREATED BY CERTAIN INVESTMENTS</u>

The definition of a "pecuniary factor" in the proposed rule is too narrow because it excludes factors that have an obvious impact on the ability of a pension fund to pay retirement benefits to its participants. The definition includes only factors that have "a material effect on the risk and/or return of the investment." *See* Proposed Rule §2550.404a-1(f)(3), 85 Fed. Reg. No. 126 at 39114. That definition treats contributions as a nonpecuniary factor. That cannot be. The dictionary definition of pecuniary is "of or related to money." *See Merriam Webster*, https://www.merriam-webster.com/dictionary/pecuniary. Contributions add money to the fund. Accordingly, if a given investment results in a pension fund receiving additional contributions, such contributions are every bit as much a pecuniary factor as any gain or loss on the investment.

Indeed, contributions are the most vital source of plan funding. That is illustrated by the fact that failing pension funds seeking benefit suspensions under the Multiemployer Pension Reform Act ("MPRA") invariably cite declining contributions as a principal factor in their projected failure to meet their obligations to retirees. Indeed, the last four applications granted for pension funds in the construction industry all represented that a principal reason for their funding shortfall was a decline in contributions. *See* Applications for Suspension of Benefits under the MPRA for the Composition Roofers Local 42 Pension Plan, Part 1 of 2 at 119 (Here); the IBEW Local 237 Pension Fund Second Application, Part 1 of 2 at 104 (Here); the Sheet Metal Workers Local Pension Fund (OH) Second Application, Application Part 1-11a at 89 of pdf (Here); and the Southwest Ohio Regional Council of

opinion that "ESG investing raises heightened concerns under ERISA" because, while private investors are free to sacrifice return in order to pursue altruistic goals, ERISA fiduciaries must invest "with an 'eye single' to maximizing the funds available to pay retirement benefits." *See* 85 Fed. Reg. No. 126 at 39115. This suggests that an implicit premise is that the increase in ESG investing is due to increased altruism, not a market consensus that ESG factors tend to increase yield and/or decrease investment risk. That proposition, however, is far from proven. Moreover, just as it is "implausible as a general rule" to allege that "a fiduciary should have recognized from publicly available information alone that the market was over or undervaluing the stock," *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, 426 (2014), it is similarly implausible to argue that a fiduciary breaches her fiduciary duty by accepting the market consensus that ESG factors provide added value to an investment acts imprudently. *See* Mehlman, Ken, *Mainstreaming ESG, Integration, Investment and Impact,* Goldman Sachs Sustainable Finance Innovation Forum 2018, https://www.goldmansachs.com/insights/pages/sfi/key-takeaways-2018.pdf.

Carpenters Second Application at Part 1 of 2 at 121 (Here), all available on the Department of Treasury Web Page.

Even in mature funds, contributions often are a larger source of funds than is investment income. Thus, in the last five years for which data is available (2014-2018), the IUPAT Industry Fund has had income of approximately $1.4 trillion from contributions, but only about $700 million from investment income.[2] Moreover, contribution income tends to be more stable than investment income. For example, during that same five-year period, investment income varied from a $118 million loss (in 2018) to a $404 million gain (in 2017), while contributions ranged from $234 million (in 2014) to $333 million (in 2018).

Given the significance of contribution income, it is not only prudent for fiduciaries to consider the fact that some investments will produce additional contributions as well as investment income; it would be imprudent for those fiduciaries not to consider that factor. A simple example proves the point. As noted in the proposed rule (85 Fed. Reg. No. 126 at 39114 n. 6), PTE 76-1, Part B permits multi-employer funds to make construction loans to participating employers. If a fund had a choice between two construction loans of similar risk, term and interest rate, and one loan would be to a participating employer who would make contributions on behalf of its employees, while the other would be to a non-participating employer and would result in no additional contributions, it obviously would be in the fund's pecuniary interest to make the former loan because that loan would result in the fund being in a better financial position at loan maturity.[3] Thus, the creation of jobs for participants, and increased contributions to the fund is a collateral benefit to the workers who get those jobs, but it also is a pecuniary benefit to the pension fund. For these reasons, any final rule should amend the definition of "pecuniary factor" to include any financial impact on the fund's ability to pay benefits.

III. MANY ALTERNATIVE INVESTMENTS ARE MATERIALLY EQUAL

It is true that virtually every investment is in some sense different from other investments. That does not mean that deciding among several alternative investments, particularly alternative investments in the same "bucket" in terms of diversification, does not essentially boil down to a coin flip. Again, a simple example proves the point.

Assume the fiduciaries have decided that 10% of the fund's assets should be invested in the large cap domestic bucket. (Virtually every investment consultant advises that the key decision is the percentage of dollars invested in each category, not the individual stocks selected within that sector). Now, the fiduciaries must fill that bucket with individual securities. Most will do so by investing in pooled vehicles, such as mutual funds, or by retaining professional portfolio managers and giving each discretion to pick the stocks to include in the large cap bucket.

But how to pick the best manager? We start with a truism. Given that all managers charge fees, the majority will do worse, net of fees, than average. *See* October 1975 Memo on Pension Investing from Warren Buffet to Katherine Graham,

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2 The discrepancy would be even larger for a relatively young fund that has little money to invest.

3 Obviously, the contributions would increase fund assets. Because the workers on whose behalf the contributions are made earn additional pension benefits, they also would increase its liabilities. In most funds, however, only a portion of each contribution dollar is needed to pay administrative expenses and fund future benefits. The remainder reduces the amount of unfunded liabilities or, if the plan is fully funded, provides a cushion against future tough times.

https://www.scribd.com/document/160301289/Warren-Buffett-Katharine-Graham-Letter at 10-12. Given that most managers employ analysts who studied at the same schools (round up the usual suspects, Harvard, Wharton, Stanford, Chicago), and have access to virtually the same information, predicting which consultants will beat the averages is virtually impossible. (*Id.*)

There literally are hundreds of professional managers in each investment category, even if one only considers those who have consistently been in the top half or the top quarter in terms of net returns. Indeed, Investor Force data shows that, net of fees, there are 875 managers of large cap equity with at least a three-year track record. Nine managers are in the 99th percentile over this period, and 225 managers are in the top quartile. Over a twenty-year period, more than 10% of all managers had performance within 20 basis points of the median. In short, ten percent of the universe is virtually tied over the last 20 years. In terms of predicting future performance, all these managers are virtually equal. Certainly, it cannot be said that retaining any manager in the top quartile would be imprudent. That remains true even if some of the managers evaluate ESG factors in making their picks.

For this reason, IUPAT agrees that the "all things being equal" standard should remain. We respectfully suggest, however, that the Department eliminate any suggestion that this situation arises infrequently.

Respectfully submitted,

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