T. Rowe Price®
INVEST WITH CONFIDENCE

Margaret H. Raymond
Vice President
Managing Counsel

July 30, 2020

Via Federal eRulemaking Portal: https://www.regulations.gov

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

RE: Financial Factors in Selecting Plan Investments Proposed Regulation, RIN # 1210-AB95

Dear Sir or Madam:

This letter provides comments of T. Rowe Price Associates, Inc. and its affiliates (collectively "T. Rowe Price") in response to the proposed rule entitled Financial Factors in Selecting Plan Investments. We appreciate the opportunity to provide comments in connection with this proposed rule.

T. Rowe Price Associates, Inc. serves as investment adviser to the T. Rowe Price family of mutual funds and collective trusts maintained by its affiliate, T. Rowe Price Trust Company. Through mutual funds and collective investment trusts, as well as its sub-advisory and separate account management services, T. Rowe Price provides investment services to retirement plans of all sizes. T. Rowe Price is the largest provider of actively-managed target date funds[1] and is known for its consistent investment process and strong investment performance at below average cost.[2] Over $510B (42%) of T. Rowe Price's total assets under management of $1.2 trillion as of December 31, 2019 were held in defined contribution retirement plans.

T. Rowe Price has, since 2017, made a conscious and public effort to increase its ability to incorporate ESG considerations into its investment decisions. This initiative was made possible by the investment we made over the prior decade to hone our expertise in evaluating ESG considerations. Development of these ESG capabilities is an outgrowth of our investment

[1] The ranking is based on actively managed target date fund assets under management, as reported in Investment News, "10 Things to Know About TDFs" (May 9, 2019 Edition).
[2] As of June 30, 2020, over 59% of all T. Rowe Price mutual funds had outperformed the median fund in their Morningstar peer group on a 1-year basis, over 64% on a 3-year basis, and over 70% and 75%, respectively, on a 5- and 10-year basis. As of that date, 85% of our mutual funds for individual investors have expense ratios below their Lipper peer category average.

T. Rowe Price Associates, Inc.
margaret_raymond@troweprice.com
T: 410-345-5724
F: 410-345-6575

Mail Code OM-1400
4515 Painters Mill Road
Owings Mills, MD 21117–4903

perspective. As we build and manage portfolios, we aim to understand each issuer's long-term financial viability and we have over the years increased our capabilities to deepen our analysis in many respects. Incorporating factors specific to ESG into our fundamental analysis is consistent with our goal of a thorough understanding of companies in which we invest for our funds and clients. Our focus has never departed from an emphasis on the long-term financial prospects for the issuers of securities we hold. In short, we share the Department's view that certain ESG factors are pecuniary factors that ***should*** be considered by prudent fiduciaries as part of the mosaic of information they use in making investment decisions.[3] We are not alone in viewing ESG considerations as important to investment decisions.

Our conviction on the usefulness of ESG pecuniary factors helps explain why we are concerned about the proposed rule. Any regulation addressing ESG needs to foster fiduciaries' prudent and loyal fiduciary decision-making, which includes ***encouraging*** evaluation of pecuniary ESG factors. The proposed rule falls short of that goal, and in the process actually poses a risk of harm to participants and beneficiaries.

We perceive three central shortcomings of the proposed rule with respect to ESG. First, the proposal is premised on an assumption—unsupported by any cited facts—that ERISA fiduciaries are currently misusing ESG. Second (and relatedly), the proposed rule does not make sufficient distinction between healthy and appropriate integration of ESG considerations into investment decisions and the distinct task of evaluating ESG-themed investments.[4] Third, the proposal fails to recognize the breadth of financial or "pecuniary" factors, and the complexity of evaluating them. These flaws work together to create a rule that, if adopted, may cause more harm to participants than good, first by causing fiduciaries unnecessarily to avoid investments and managers that appropriately employ ESG integration, and second by discouraging fiduciaries from selecting ESG-themed investments that might improve financial outcomes in retirement for their participants and beneficiaries.

The proposed rule also inappropriately addresses non-ESG issues. Without any identification of the problem to be solved, the proposal grafts new principles onto a four-decade old rule that has served participants and beneficiaries well. These additions are neither needed nor helpful.

[3] 85 Fed. Reg. at 39115: "[The Department] recognized that there could be instances when ESG issues present material business risk or opportunities to companies that…qualified investment professionals would treat as economic considerations under generally accepted investment theories. In such situations, the issues are themselves appropriate economic considerations, and thus ***should be considered by a prudent fiduciary*** along with other relevant economic factors to evaluate the risk and return profiles of alternative investments." [Emphasis added.]

[4] We note the importance of vocabulary. We use the phrase ESG-themed investments to refer to funds that either seek to impose limits on investments based on values (sometimes called "socially responsible investments") as well as those seeking to further a particular ESG perspective (sometimes called "impact investments") The use of the phrase "ESG-focused investments" can be misleading in that it can create confusion between pooled vehicles in which the investment manager has appropriately used ESG pecuniary factors and vehicles in which ESG considerations are part of the investment thesis.

T. Rowe Price
INVEST WITH CONFIDENCE

Our specific comments follow.

1. There is no factual support for the proposition that ESG is being misused currently. Accordingly, the proposed rule's efforts to impose new requirements on fiduciaries' consideration of ESG is not necessary.

The proposal notes[5] (a) that the term "ESG" is being used more frequently by institutional asset managers, (b) more ESG ratings services exist, and (c) more ESG funds are being offered. From this, the proposal constructs a "concern" that the growing emphasis on ESG "may" be prompting inappropriate plan fiduciary decision-making.[6] Yet none of the cited factors support the contention that harm is occurring to ERISA-governed plans and participants that must be remedied by regulation.

The fact that the term "ESG" is used more frequently does not indicate any improper fiduciary decision-making. First, other regulators are requiring consideration of financially material ESG factors and focusing on the importance of the disclosure of those factors. European regulators have imposed rules, effective March 10, 2021, that ***require*** investment managers governed by the regulation to incorporate financially material ESG factors into the investment process. The U.S. Securities and Exchange Commission has also noted the importance of disclosing ESG factors to the extent that they are material.[7] In light of these two factors, more frequent reference to ESG is hardly surprising. Second, the increased use of the term reflects increased recognition of the healthy and appropriate consideration of pecuniary ESG factors that can impact a particular investment's risk or expected return. (T. Rowe Price's own enhanced capabilities to evaluate ESG considerations as pecuniary factors exemplify that). As the Department itself notes,[8] ESG factors that impact risk or expected return "***should***" be considered by a prudent fiduciary. There is nothing sinister in the increased use of the term "ESG" by investment managers.

The fact that there are more ESG ratings reflects the increased demand among investors to understand the extent to which ESG considerations are financially material. The existence of some ratings that may not be reliable is immaterial. Like many other investment managers, T. Rowe Price does not make investment decisions on the basis of an ESG rating conferred by a third party but subscribes to ratings services because they provide additional information about particular aspects of ESG that might impact a company's long-term prospects.

[5] 85 Fed. Reg. at 39115.
[6] 85 Fed. Reg. at 39116.
[7] *See, e.g.*, SEC Interpretive Release Nos. 33-9106, 34-61469, FR-82 (February 8, 2010) and Public Statement of Chairman Jay Clayton (January 30, 2020), reprinted at https://www.sec.gov/news/public-satment/clatown/mda/2020/01-30#_ftn9 (last accessed July 22, 2020).
[8] 85 Fed. Reg. at 39115.

The greater availability of "ESG-focused funds"[9] does not correlate with a substantial increase in the use of such funds for ERISA plan investing. Even if small percentages of defined contribution plans are using ESG-themed funds,[10] that statistic alone does not demonstrate that plan fiduciaries have acted inappropriately by subordinating pecuniary interests to non-pecuniary interests.

The Department itself assumes[11] that most fiduciaries are operating in compliance with the Department's sub-regulatory guidance that already cautions against subordination of the financial interests of participants and beneficiaries to non-financial interests. We agree with that assumption. There is simply no demonstrated harm that necessitates the proposed rule.

2. The proposed rule imposes a burden on the important task of considering ESG factors when evaluating an investment. This burden is not only unnecessary but potentially harmful.

The proposed rule seeks to 'cure' alleged improprieties in use of ESG considerations by imposing special duties on fiduciaries using such criteria. The proposed rule singles out ESG considerations by warning fiduciaries about the importance of giving the factors appropriate weight and imposing specific due diligence considerations (level of diversification, degree of liquidity and potential risk in comparison to other available alternatives). This additional due diligence requirement serves to discourage, not encourage appropriate consideration of ESG factors, even if they are pecuniary factors. The specific requirement concerning ESG (as opposed to any other, more foundational pecuniary factor like financial stability) is only appropriate if investment managers are not appropriately evaluating ESG factors, i.e., are not limiting the influence of these factors to situations in which the ESG factor appears to impact risk or expected return. As noted above, no data support this assumption.

This regulatory skepticism is not without cost. If additional burdens are required to even evaluate ESG considerations relative to a particular investment, then some managers of ERISA assets may be tempted to forego that evaluation even though ESG should be evaluated. Worse, these burdens may skew fiduciaries' choice of investment managers and products. Those fiduciaries that would prefer to avoid the extra task of evaluating a manager's compliance with this extraordinary due diligence requirement might steer away from managers like T. Rowe Price that emphasize the importance of integrating financially material ESG considerations into their investment approach. If that occurs, the proposed rule could limit investment choice and cause plan fiduciaries to make suboptimal decisions with respect to investment managers and investment products.

The Department's cost-benefit analysis for this regulation suggests that a move away from investments that integrate ESG may be beneficial because it will drive more investors to passively

[9] 85 Fed. Reg. at 39115. Note that the proposal's use of the term "ESG-focused funds" leaves unclear whether the Department is concerned about an increase in ESG-themed funds, or an increase in funds using appropriate evaluation of material ESG factors.
[10] 85 Fed. Reg. at 39121.
[11] 85 Fed. Reg. at 39120.

T.RowePrice®
INVEST WITH CONFIDENCE

managed investments with lower fees or other cheaper investments.[12] If investments are cheaper because the manager declines to evaluate factors that should be considered because they are financially material, that is not an outcome benefitting participants and beneficiaries. Certainly, there is no consensus that passive investing is inherently superior to investing in active investment management,[13] nor has the Department cited evidence in its preamble supporting the proposition that a rule driving retirement plans to passive investing would result in better outcomes for participants and beneficiaries. The Department should not use its regulatory authority to sway fiduciaries towards passive management over active management.

3. The proposed rule's conclusion that "ties" are rare misapprehends the complexity of evaluating investments. As a result, the Department underestimates the true burden of its proposal.

In keeping with prior sub-regulatory guidance, the proposed rule supports the use of non-pecuniary ESG factors as a tie-breaker when two potential investments are "economically indistinguishable." Unlike prior sub-regulatory guidance, the proposed rule places additional documentation requirements on fiduciaries who reach a conclusion of economic equivalence and use a non-pecuniary ESG consideration as a tie-breaker. The proposal discounts the impact of this burden on the investing public on the grounds that such ties are rare.

The proposed rule appears to assume that evaluation of two alternative investments based solely on pecuniary factors can be reduced to a single number. That assumption underestimates the complexity of portfolio construction. Choices between two alternatives are often based on a mosaic of factors. Option 1 can be attractive on an anticipated return axis but slightly more problematic on a risk axis than Option 2. In such a case, the choice between two alternatives requires some subjectivity and, more importantly, judgment.

By declaring economic equivalence "rare," the proposed rule actually creates two hurdles. Fiduciaries will be pressed to determine that their judgment as to the rough equivalence of two alternative securities is truly an example of economic equivalence. Then, as noted, the fiduciary using a non-pecuniary ESG factor will need to engage in special documentation if the non-pecuniary ESG consideration influences the final choice.

Both the task of determining a tie, and the necessity of documenting the use of ESG as a tie-breaker are difficult and burdensome. In combination, they may make a fiduciary hesitant to give more weight in the mosaic even to pecuniary ESG considerations, for fear that it will be accused of

[12] 85 Fed. Reg. at 39121.

[13] The academic debate about the relative merits of active investing compared to passive investing continues. There is no consensus that passive investing delivers uniformly superior financial outcomes. *See, e.g.,* "Challenging the Conventional Wisdom on Active Management: A review of the Past 20 Years of Academic Literature on Actively Managed Mutual funds, Financial Analysts Journal, Vol. 75, No. 4 (Fourth Quarter 2019), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3247356 (last accessed July 22, 2020).

letting non-pecuniary ESG factors sway a decision between roughly comparable choices without appropriate documentation.

4. In the context of selecting investments for a defined contribution plan menu, the proposed rule underestimates the factors that can meaningfully impact participants' financial outcomes. By outlawing the use of those factors, the proposed rule could damage retirement outcomes for certain participants and beneficiaries.

The proposed rule discounts the importance of a defined contribution plan menu. Menus are generally designed to offer a range of investment vehicles with materially different risk and return characteristics, such that participants can create their own optimal portfolio, reflecting individual preferences for risk and expected return. Menus are also designed to encourage plan participation. Today, in selecting investment options for a menu, plan fiduciaries take into account the stability and reputation of the investment firm offering potential investment vehicles, along with other appropriate characteristics. In this vein, it is also appropriate for fiduciaries to take into account the preferences and attributes of the plan population. If a significant portion of a plan's participant demographic demands one or more ESG-themed investments, then prudent fiduciaries should give consideration to offering one or more ESG-themed investments on the menu. This is no different than offering investment options that have historically low volatility to appeal to conservative investors, sector funds in plans where a significant number of participants seek investment exposure to particular categories of industries, or retirement income options for plans with participants seeking predictable retirement income. If prudent fiduciaries are not allowed to consider participant demand a financially relevant factor, participants and beneficiaries may be harmed. Participants that cannot find investment choices that suit them may forego saving through employer-based plans or may even forego saving for retirement altogether.

The proposed rule seeks to hamstring fiduciaries who would augment their menu with an ESG-themed investment by appearing to require that the fact of an investment's ESG theme cannot factor into the decision to select that investment (or factor into its monitoring). The proposed rule requires that selection be based on objective factors, and then provides an exemplary list of such factors. Notably, the fact of the ESG theme is conspicuously absent from the representative list of permissible objective considerations. This leads to the conclusion that the proposed rule intends that fiduciaries can only include an ESG-themed investment if they stumble across it in their search based on other allegedly "objective" factors.

We are concerned about the representative list of objective factors for another reason. First, the list creates some question about what the Department means by an objective factor, as some of the factors on the list, although worthy of consideration by prudent fiduciaries, may not be "objective" (such as investment manager expertise). Second, some factors that are appropriately part of a prudent fiduciary's exercise of discretion, such as the reputation of the investment management firm, are omitted from the representative list. More importantly, the requirement that only objective factors be considered has another potential flaw. Prudent fiduciaries often apply subjective judgement in evaluating objective factors. Some fiduciaries may have preferences for a particular style of investing (active or passive) or a particular vehicle structure (mutual funds over trusts) or may give one specific objective factor more weight than another fiduciary does. Promulgating a rule that requires consideration of only "objective factors" may be interpreted to ban subjective weighing of these factors and disrupt current prudent fiduciary practices. Such an outcome would have implications far beyond the consideration of an ESG-themed investment.

Finally, there is no rationale for imposing an absolute bar on the use of ESG-themed investments as components of qualified default investment alternatives (QDIAs). If a plan has prudently selected ESG-themed investments and those investments can satisfy the need for a particular asset or sub-asset class, then there should be no bar on including those investments in a managed account offering or custom target date fund that has been designated as a QDIA.

To the extent that the rule requires fiduciaries to ignore participant preferences with respect to ESG-themed investments, it is not only unwarranted, it is dangerous. We believe that the participant-directed defined contribution plan structure has allowed many to achieve financial security in retirement, but for most plans, success depends on individuals' willingness to participate. If we want the employer-sponsored defined contribution plan system to continue providing meaningful retirement outcomes for participants and beneficiaries, it cannot be made less attractive for participants. In this respect, consideration of participant preferences is an appropriate financial consideration.

5. The proposed changes to provisions unrelated to ESG are unnecessary and unwise.

If the factual basis for this rule is thin with respect to ESG, it is non-existent for changes that are unrelated to ESG. The preamble is devoid of any explanation as to why the changes are required. Instead, the Department proposes that it is simply "elaborating" on core principles.

The additions are not simple elaborations, but an unsupported development of a new theory of loyalty. The obligation of prudence is distinct from the obligation of loyalty. Yet, the proposed rule purports to interpret loyalty and prudence as requiring identical steps. Unlike prudence, loyalty has not been interpreted by the courts to be an objective test requiring compliance with appropriate procedures, but has instead been measured by the subjective intent of the fiduciaries. Further, courts have not extended the duty of loyalty to prohibit any fiduciary consideration of implications external to the fiduciary's own interest, so long as the fiduciary was focused on benefiting participants and beneficiaries and defraying reasonable plan expenses. *See, e.g., Wildman v. American Century Services, LLC*, 362 F. Supp. 3d 685, 700-01 (W.D. Mo. 2019) (evaluation of loyalty focuses on the reason a fiduciary acted, and whether it was motivated by subjective good faith); *Brotherston v. Putnam Invs., LLC*, 907 F.3d 17, 40 (1st Cir. 2018) (loyalty is a subjective analysis). In failing to acknowledge the distinction between loyalty and prudence and failing to carefully articulate loyalty principles as interpreted by the courts, the proposed rule does far more than codify existing law. Such a change should not be undertaken without a demonstration of harm that the change is designed to address, and an articulation of why the proposed change is an appropriate means of addressing the harm.

Perhaps more disturbing is the proposal's requirement of consideration of "alternatives" in every instance. In some cases, there may be no true alternative to a particular investment, because the opportunity is so unique. In other cases, the opportunity may lapse if a thorough undertaking of all alternatives is pursued. In yet other situations, the number of potential alternatives might be so numerous that consideration of every alternative is impossible.[14] The proposal is unclear as to extent of the requirement to evaluate alternatives. This lack of clarity may give rise to inappropriate second-guessing in which questions are raised as to whether a particular alternative (selected with the benefit of hindsight) should have been considered. There is no reason to create an ambiguous rule that will be used in frivolous litigation, especially when there is no reason to believe that this new requirement addresses any known defect or harm.

*****

In our view, the proposed rule is attempting to solve a problem that does not exist. Worse, the proposed rule discourages fiduciaries from taking into account ESG factors that should be considered, imposes unnecessary burdens on investment decisions including those involving ESG, and requires defined contribution plan fiduciaries to disregard considerations that are important to participants' future financial security. Changes in the original 1979 rule that are not specific to ESG represent dramatic changes in the law and will result in increased litigation without any demonstrated benefit. We urge you to withdraw the proposed rule, and initiate requests for information before engaging in additional rulemaking on this topic.

Sincerely yours,

Margaret Raymond

MHR/tms

[14] Consider the obstacles that the manager of a global growth equity mandate might face. That manager would be required to scour the globe for potential equities that might be characterized as growth stocks and consider each one of thousands of alternatives, lest the manager be subsequently criticized for having failed to evaluate a specific alternative favored by the challenger.