Revenue Enablement Institute

July 30, 2020

The Hon. Eugene Scalia, Esq.
Secretary
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

RE: RIN 1210-AB95: Proposed Rule, "Financial Factors in Selecting Plan Investments"

Dear Secretary Scalia:

Thank you for this opportunity to offer my thoughts on this Proposed Rule from your Department's Employee Benefits Security Administration (EBSA). The Administration should be congratulated for providing much-needed regulation over how pension fiduciaries select their investments relative to the legal mandates enshrined in the Employee Retirement Income Security Act of 1974 (ERISA).

As stated on page three of the Rule, "The Supreme Court as recently as 2014 unanimously held in the context of ERISA retirement plans that such interests must be understood to refer to 'financial' rather than 'nonpecuniary' benefits, and federal appellate courts have described ERISA's fiduciary duties as 'the highest known to the law.'"[1] This brings me to the first point I would like to raise: the issue of automatic exclusion.

The overarching theme of this ruling is that pension funds cannot select environmental, social, and governance (ESG) investments unless those selections can be proven to generate returns that are expected to be on par with, or greater than, traditional investment selections that use financial (i.e., pecuniary) criteria that is universally accepted. Professional fund managers can no longer simply rely on their "professional opinion". They need to present hard data to justify such selections. With that in mind, which companies should be excluded from the start from an ESG fund? Given that there is no one recognized standard for exclusion – or inclusion – we find ourselves in a tenuous situation.

A perfect example of this predicament, I believe, is the MSCI KLD 400 Social Index. According to its prospectus, the index is "a capitalization weighted index of 400 US

---

[1] Employee Benefits Security Administration, Proposed Rule: "Financial Factors in Selecting Plan Investments", June 30, 2020, https://beta.regulations.gov/document/EBSA-2020-0004-0002.

securities that provides exposure to companies with outstanding Environmental, Social, and Governance (ESG) ratings and excludes companies whose products have negative social or environmental impacts."[2] This begs the question: should fund managers charged with maximizing the returns on other people's money dictate what is a negative social or environmental impact? I do not believe so; and, more importantly, ERISA law forbids it, for these impacts are non-pecuniary.

If a manufacturer is leaching toxic chemicals into a river, or if a company's management team is severely dysfunctional, there are consequences to the company's financial performance that everyone understands and expects. However, here are the categories of companies that KLD Index automatically excludes:

- Nuclear power providers
- Cigarette manufacturers
- Alcohol companies
- Casinos
- Defense contractors
- Gun makers
- Agrochemical companies that produce genetically modified organisms (GMOs)
- Strip clubs

Since many people believe abortion is as equally murderous as a gun manufacturer, should companies that promote women's reproductive rights be placed on this excluded list, as well? The slope is indeed slippery. Everyone has the right to invest his or own money in whatever ESG or socially conscious fund or company they wish. But this type of investing is not appropriate for pension funds managing the retirement savings of firefighters, nurses, engineers, teachers, and many others. Moreover, it would be advantageous for the Department to clarify if the new regulations set forth in this rule mean that particular investments cannot be automatically excluded if they fall into a particular category.

Finally, the main reason I support this ruling is because it addresses head-on the fact that, as I stated earlier, there is no one, clear, financially valid definition of "ESG", or social, sustainable, or value-based investing for that matter. In my work, I am regarded as an expert in placing a financial value on marketing intangible assets – such as Brand Equity, CSR (Corporate Social Responsibility Programs), and Cause Related Marketing investments. While these intangibles have financial value, they only create shareholder value in a customer context, and in no way apply to institutional investment performance.

As such, it is incredibly challenging for a fiduciary to claim an investment steeped in non-pecuniary factors can pass muster. Over the past several years, I have worked with the Marketing Accountability Standards Boards, The International Standards Setting Organization (ISO), Wharton Business School, and several corporate boards to design financially valid, externally validated, and fully transparent metrics to report and

---

[2] MSCI, MSCI KLD 400 Social Index (USD), https://www.msci.com/documents/10199/904492e6-527e-4d64-9904-c710bf1533c6.

measure the financial contribution of marketing intangible assets on firm value, future cash flows, and firm financial performance. The math that connects marketing investments like Cause Related Marketing to shareholder value is extremely challenging. And as of now there is no agreement with accounting standard setting bodies on the correct way to report these intangibles to shareholders and investors in financial statements. Similarly, while some day we will hopefully have a standardized system to assess ESG investments, we are not there yet. In my mind, that is the crux of why this rulemaking is so important in today's investing climate.

If an ESG strategy is so viable, then it should be rewarded by customers and reflected in the company stock price performance, which is the only valid basis to pick investments. Additionally, ESG applies to retail investing and consumer marketing. If people are willing to pay more or even buy an underperforming fund because it saves the whales, fantastic. But that is not acceptable for public and private pension plans.

To summarize, I fully concur with the following language in the proposed rule: "The Department's longstanding and consistent position, reiterated in multiple forms of guidance and based on the explicit language of ERISA itself, is that plan fiduciaries when making decisions on investments and investment courses of action must be focused solely on the plan's financial risks and returns, and the interests of plan participants and beneficiaries in their plan benefits must be paramount."[3]

I appreciate all the effort the Department and especially the EBSA have put into this proposed rule. Thank you again for considering my thoughts on this important issue of protecting retirement savings.

Respectfully,

Stephen Diorio
Executive Director
Revenue Enablement Institute

[3] Employee Benefits Security Administration, Proposed Rule: "Financial Factors in Selecting Plan Investments", June 30, 2020, https://beta.regulations.gov/document/EBSA-2020-0004-0002.