July 30, 2020

Mr. Joe Canary, Director
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

Submitted Electronically Through www.regulations.gov

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

Dear Mr. Canary:

North America's Building Trades Unions (NABTU) is an alliance of 14 national and international unions in the building and construction industry that collectively represents over 3 million skilled craft professionals in the United States and Canada. These members participate in multiemployer, defined benefit plans that provide a lifetime of retirement security and collectively invest over $500 billion in assets.

Summary of Comments

As discussed below, NABTU strongly agrees with certain aspects of the proposal, makes specific recommendations to clarify and strengthen the proposal, and disagrees with aspects of the Department's positions.

We also believe this rulemaking undermines the President's May 19th, 2020, Executive Order that directs agencies to cut regulations that inhibit economic recovery. Instead of cutting regulation, the Department of Labor has chosen to take the opposite approach.

Multiemployer pension funds have a multi-decade track record of successfully investing in what is often referred to as "Economically Targeted Investments" that provide competitive risk adjusted returns through investments that contribute to a well-diversified portfolio. We also document the pecuniary nature of plan contributions and the unique ability for multiemployer pension plans to make investments that generate plan contributions that further the financial interests of the plan.

We support the Department's decision to "retain the all things being equal test" under the Department's previous guidance, but we view the Proposed Regulation as rejecting that test in favor of a more narrow, restrictive and ultimately unworkable standard that does not reflect a prudent approach to considering investment alternatives. We also provide a more complete understanding of the financial markets and explain that "ties" between investment alternatives occur more often than understood by the Department.

I. Economically Targeted Investments (ETI) Serve the Financial Interests of our Member's Plans

The Department of Labor (the Department or DOL) cited that "Various terms have been used to describe this and related investment behaviors, such as socially responsible investing, sustainable and responsible investing, environmental, social, and corporate governance (ESG) investing, impact investing, and economically targeted investing. The terms do not have a uniform meaning and the terminology is evolving."

This statement conflates two very different terms, economically targeted investment (ETI) and environmental, social & governance (ESG) factors.

In the context of NABTU's multi-employer pension funds, ETI seeks to generate risk-adjusted market rate of returns while also (secondarily and where appropriate) promoting plan contributions through job creation and economic development.

ESG integration, by contrast, is the consideration of ESG factors as part of prudent risk management, and a strategy to take investment actions aimed at responding to those risks.

A. Pecuniary Factors

The Department's focus on the pecuniary factors and the interests of the plan, its participants, and beneficiaries is appropriate. However, as currently constructed, the Department fails to distinguish between the different types of defined benefit pension plans and how pecuniary factors might differ between different types of ERISA plans. Specifically, multiemployer defined benefit pension plans are considerably different from single employer defined benefit pension plans.

These differences include the source and nature of the plan contributions, the pecuniary impact of contributions on the plan, its participants, and beneficiaries, as well as the ability of the plan to make investments that advance, promote and support the pecuniary interests of the plan.

Unlike single employer plans, multiemployer plans have a significant track record of making investments that earn competitive risk adjusted returns, and directly put plan participants to work that, in turn, generates new contributions to the plan. All of which is consistent with (1) trustees acting "solely in the interests of the participants and beneficiaries" and the "exclusive purpose" requirement of "providing benefits", and (2) the prohibited transaction provision of 29 USC §1106.

Multiemployer pension plans receive plan contributions principally based on the hours worked of an individual participant. Therefore, if an investment puts a participant to work, the plan receives contributions that it would not have otherwise had, the participant earns a pension benefit, and the plan receives contributions that, as discussed below, are either first used to pay the benefits of current retirees, or being used to reduce the unfunded accrued liabilities of the plan.

Analysis of DOL Form 5500 data demonstrates the pecuniary importance of contributions to multiemployer pensions. The chart below demonstrates that over the past four years for which multiemployer pension Form 5500 data is available, contributions provided multiemployer plans with materially significant income (pecuniary support) relative to both benefits paid and the net investment income of plans.

Contributions are the most liquid asset that plans have, and given that the benefits paid in each of the plan years exceed the contributions, it is obvious that contributions are the first source of funding for current benefits. This is a rational choice so that the portfolio is not unnecessarily divested. It is also the clearest demonstration of the vital pecuniary impact that contributions have on multiemployer pension plans and the economic interests of the plan, its participants and beneficiaries.

Multiemployer Pension Data (Source: U.S. Department of Labor, Form 5500)

Plan Year Ending	**2015**	**2016**	**2017**	**2018**
Number of Multiemployer Plans	1,296	1,242	1,231	1,220
Assets ($ Billions)	$474.5	$480.9	$527.6	$523.3
Benefits Paid ($ Billions)	$41.0	$42.0	$45.5	$43.9
Plan Contributions ($ Billions)	$27.9	$28.3	$30.0	$32.3
Contributions as a Percent of Assets	5.9%	5.9%	5.7%	6.2%
Net Investment Income ($ Billions)	$2.0	$20.5	$70.0	$9.0
Contributions as a Percent of Net Investment Income	1,393.0%	138.0%	42.9%	358.9%

However, as we recognize, the multiemployer pension system suffers from unfunded liabilities for benefits that are owed to current retirees and active and inactive vested participants. While we have demonstrated that the current benefit payments exceed contributions, the Department may not consider contributions to be allocated to benefit payments. In that case, it is clear that contributions are a pecuniary factor as a vital source of funding to reduce the unfunded liabilities that are owed to plan participants and beneficiaries.

In either case, the DOL Form 5500 data supports the fact that the majority of contributions are used for these purposes which further demonstrates the pecuniary impact of contributions that are (1) solely in the in interest of the participants and beneficiaries[1] and for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of

[1] 29 USC § 1104(a)(1)

administering the plan[2] and (2) consistent with "an "eye single" to maximizing the funds available to pay retirement benefits."[3]

B. Recommended Changes to Proposed Regulations

This leads to our recommendation that DOL amend proposed sections 2550.404a-1(b)(1)(ii) and 2550.404a-1(f)(3) to include, where relevant, contributions to the plan as recognized pecuniary factors.

For example, 2550.404a-1(b)(1)(ii) would now read:

> **"(ii)** Has evaluated investments and investment courses of action based solely on pecuniary factors that have a material effect on (A) the return and risk of an investment based on appropriate investment horizons and the plan's articulated funding and investment objectives insofar as such objectives are consistent with the provisions of Title I of ERISA, and where relevant (B) contributions to the plan;"

For example, 2550.404a-1(f)(3) would now read:

> **"(3)** The term ***"pecuniary factor"*** means a factor that has a material effect on (i) the risk and/or return of an investment based on appropriate investment horizons consistent with the plan's investment objectives and the funding policy established pursuant to section 402(a)(1) of ERISA, and where relevant (ii) contributions to the plan."

II. Tie-Breaker Considerations and Comment

We support the DOL's decision to "retain the 'all things being equal test' from the Department's previous guidance." We note, however, that it is far from clear that DOL has actually retained the standard.

Instead, it appears that the applicable standard, first formally recognized by the DOL in 1994 and retained by each subsequent administration,[4] has been replaced with an "economically indistinguishable" standard. *See, e.g.*, 29 C.F.R. § 2550.404a-1(c)(2) (proposed). Indeed, we point out that neither the phrase "all things being equal" nor "tiebreaker" actually appear in the Proposed Regulations themselves.

The Department does correctly state in its preamble that "alternatives would remain two different investments that may function differently in the overall context of the fund portfolio, and which going forward may perform differently based on external economic trends and developments." 85 Fed. Reg. 39117. From this, however, the Department reaches the erroneous conclusion that non-

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[2] 29 USC § 1104(a)(1)(i) and (ii)

[3] *Donovan v. Bierwirth*, supra. 680 F.2d at 271.

[4] The "all things being equal" or "tiebreaker" standard was initially set out as official guidance by the Department in IB 94-1 (Fed. Reg. Vol 59, No. 120, p. 32606, June 23, 1994), and, up to now, had been maintained through each subsequent administration, including this one. *See*, IB 2008-1 (Fed. Reg. Vol. 73, No. 202, p. 61734, October 17, 2008); IB 2015-1 (Fed. Reg. Vol 80, No. 206, p. 65135, October 26, 2015); FAB 2018-01 (April 23, 2018).

pecuniary factors may only be considered where the performance of the two investments could be expected to be identical in all circumstances.

This is a substantial departure from earlier guidance. Indeed, the extreme and inappropriately rigid narrowing of the standard in the proposed regulation is striking. Thus, although the phrase "economically indistinguishable" appears in the Department's 2008 guidance, it does so in a much broader context:

> "Situations may arise, however, in which two or more investment alternatives are of equal economic value to a plan. The Department has recognized in past guidance that under these limited circumstances, fiduciaries can choose between the investment alternatives on the basis of a factor other than the economic interest of the plan. The Department has interpreted the statute to permit this selection because (1) ERISA requires fiduciaries to invest plan assets and to make choices between investment alternatives, (2) ERISA does not itself specifically provide a basis for making the investment choice in this circumstance, and (3) the economic interests of the plan are fully protected by the fact that the available investment alternatives are, from the plan's perspective, economically indistinguishable.
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> Given the significance of ERISA's requirement that fiduciaries act "solely in the interest of participants and beneficiaries," the Department believes that, before selecting an economically targeted investment, fiduciaries must have first concluded that the alternative options are truly equal, taking into account a quantitative and qualitative analysis of the economic impact on the plan. ERISA's fiduciary standards expressed in sections 403 and 404 do not permit fiduciaries to select investments based on factors outside the economic interests of the plan until they have concluded, based on economic factors, that alternative investments are equal." 73 Fed. Reg. 61735.

This formulation fundamentally differs from the current proposal. In the 2008 guidance, the review of the equivalence of the investments is in the context of "from the plan's perspective." In other words, the individual investment must be viewed from the perspective of the plan's investments as a whole, and the intended role of those alternatives within the overall investment portfolio. Indeed, the review of the alternative investments must "tak[e] into account a quantitative and qualitative analysis of the economic impact on the plan". This is a far cry from what the Proposal appears to require, which is that the alternatives under consideration have:

> "the same target risk-return profile or benchmark, the same fee structure, the same performance history, same investment strategy, [and that it not] function differently in the overall context of the fund portfolio, and [not] perform differently based on external economic trends and developments." 85 Fed. Reg. 39117.

In short, the prior standard, which is best characterized as functional equivalence, is replaced with a brand-new mathematically identical standard.

DOL states that "The Department expects that true ties rarely, if ever, occur." That may be true under the new standard. DOL goes one to say "To be sure, there are highly correlated investments and otherwise very similar ones. Seldom, however, will an ERISA fiduciary consider two investment funds, looking only at objective measures, and find the same target risk-return profile or benchmark, the same fee structure, the same performance history, same investment strategy, but a different underlying asset composition."

This statement suggests that fiduciaries have perfect and real-time information about all of the investable assets in the global markets and that each fiduciary will analyze each investment in identical ways. Neither of these assumptions is accurate. Further, in any analysis of an investment, there are a number of subjective factors unique to each investment that need to be considered. This is consistent with any interpretation of modern investment and portfolio theory, which the Department inexplicably fails to recognize in its analysis.

There are more than 165,000 people who hold the Chartered Financial Analyst (CFA®) designation from the CFA Institute and countless more people who are not CFA's but who are involved professionally as securities analysts. There are nine Nationally Recognized Statistical Ratings Organization (NRSRO's) registered with the SEC. There are hundreds of firms nationally and globally that analyze all manner of investments either as direct investors or as providers of analyses. In an industry largely based on human judgment (although increasingly incorporating Artificial Intelligence), the notion that ties will be rare defies logic and experience.

Participants in the financial markets produce both "ties" and widely differing views on the exact same securities all the time. Given the number of analysts and firms that provide all manner of analysis, this should not be surprising. Further, there is also an entire industry within the investment community that is built around mispriced market ties, known as arbitrage.

In a global market with so many participants, imperfect information, competing investment theories and methodologies, differing human experiences, biases, judgments, and levels of education, ties are actually not uncommon between any particular investor.

Additionally, where the global equity market capitalization was $74.7 trillion[5], global bond market outstanding was $102.8 trillion[6], private equity investments were nearly $4.5 trillion[7], and $29.9 trillion in U.S. private businesses[8], the size of the investable universe alone suggests that the concept of ties would not be as remote as the Department believes.

The real world of investing is far from the Department's utopian universe where information is perfect, in real-time and without subjective considerations. The timeline for an investment decision

[5] SIFMA, Capital Markets Fact Book 2019, page 40. See https://www.sifma.org/wp-content/uploads/2019/09/2019-Capital-Markets-Fact-Book-SIFMA.pdf.
[6] Ibid, 37.
[7] Institutional Investor, Schelling, Christopher, *The Truth About Private Equity Fund Size*, December 9, 2019. See https://www.institutionalinvestor.com/article/b1jd43sxkzt8jn/The-Truth-About-Private-Equity-Fund-Size.
[8] Board of Governors of the Federal Reserve System, Federal Reserve Statistical Release, *"Z.1 Financial Accounts of the United States: Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts", First Quarter 2020*, June 11, 2020. B.103 Balance Sheet of Nonfinancial Corporate Business, page 139 and B.104 Balance Sheet of Nonfinancial Noncorporate Business, page 140.

for a plan varies greatly for any particular investment or investments, and can range from mere milliseconds to years. There are great time lags in any required reporting but particularly for funds, which often means that the underlying asset composition is not known with the precision that the Department believes. There are a large number of investments where the underlying asset composition is not known with certainty and never could be, and numerous other factors that will only be known to varying degrees of accuracy and certainty.

This can result from many factors including time-lags, the lack of detailed reporting requirements, the private nature of a many businesses, and the proprietary nature of the underlying business operations of even the most public of companies. The investment profession has always required the use of judgment based on imperfect information. It is equally true that investment strategies are known to drift for a variety of reasons including the level of asset prices, rebalancing timeframes, and personnel.

All of this suggests that in the evaluation of two of more investment options, the types, accuracy and completeness of information and data varies. This leads to a more subjective analysis than the Department outlined, which further supports the idea that ties are not an inconceivable outcome, and are unlikely to be "rare". **As a result, we support the Department's decision to retain the "all things being equal" test under the Department's previously articulated standards, and encourage the Department to revisit the misguided assumption that these occurrences are rare**.

Additionally, the new standard proposed by DOL – the requirement of being mathematically identical – ignores modern "generally accepted investment theories" by apparently requiring individual investments to be viewed in isolation *See, e.g., Ibid.* Indeed, the Proposal includes language flatly contradicts its own conclusion:

> "[I]t remains the Department's view that (1) generally the relative riskiness of a specific investment or investment course of action does not render such investment or investment course of action either per se prudent or per se imprudent, and (2) the prudence of an investment decision should not be judged without regard to the role that the proposed investment or investment course of action plays within the overall plan portfolio. It also remains the Department's view that an investment reasonably designed—as part of the portfolio—to further the purposes of the plan, and that is made with appropriate consideration of the relevant facts and circumstances, should not be deemed to be imprudent merely because the investment, standing alone, would have a relatively high degree of risk. The Department also believes that appropriate consideration of an investment to further the purposes of the plan must include consideration of the characteristics of the investment itself and how it relates to the plan portfolio." 85 Fed. Reg. 39116.

Thus, as explicitly noted in the above language, even an investment that, standing alone, may fail the proposed standard, should prudently and lawfully be part of the investment portfolio of an ERISA-covered plan. Far from requiring that investments be "economically indistinguishable", this language militates for the conclusion that each investment must be considered in the context of the entire investment portfolio.

Furthermore, applying generally accepted investment theories, multiemployer plan portfolios are constructed based upon the characteristics of the entire portfolio – a theory known as the "efficient frontier". As explained in one scholarly article:

> Efficient Frontier . . . is a key concept of [Modern Portfolio Theory]. It represents the best combination of securities (those producing the maximum expected return for a given risk level) within an investment portfolio. It describes the relationship between expected portfolio returns and the riskiness or volatility of the portfolio. It is usually depicted in graphic form as a curve on a graph comparing risk against the expected return of a portfolio. The optimal portfolios plotted along this curve represent the highest expected return on investment possible, for the given amount of risk. Portfolios lying on the 'Efficient Frontier' represent the best possible combination of expected return and investment risk.
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> The relationship between securities within a portfolio is an important part of the Efficient Frontier. . . . One of the major implications of . . . Efficient Frontier theory is its inferences of the benefits of diversification. Diversification, as discussed above, can increase expected portfolio returns without increasing risk. [R]ational investors seek out portfolios that generate the largest possible returns with the least amount of risk—portfolios on the Efficient Frontier. *A Simplified Perspective of the Morkowitz Portfolio Theory,* Myles E. Mangram, Global Journal of Business Research, Volume 7, November 1, 2013, p. 60.

Thus, the appropriate question is not whether an individual investment is "economically indistinguishable" from an alternative. More properly, it is whether the alternatives, in the context of the plan's portfolio as a whole, place the portfolio on an equally appropriate part of the "efficient frontier." Manifestly, that does not require that the investments be economically indistinguishable.

III. Conclusion

Multiemployer pension funds rely on investment returns and plan contributions to further the financial interests of the plan and provide a secure retirement for its participants. We strongly encourage the Department to explicitly recognize the economic opportunities and pecuniary nature of Economically Targeted Investment in its final rulemaking.

Further, we urge the Department to retain the all things being equal test, without unnecessarily implementing a rigid and unworkable rule that limits the ability of plans to weigh material economic considerations.

With kind regards, I am

Sincerely,

Sean McGarvey
President