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WELLINGTON
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30 July 2020

Office of Regulations and Interpretations
Employee Benefits Security Administration
US Department of Labor
200 Constitution Ave., NW
Washington, DC 20210

Re: Financial Factors in Selecting Plan Investments (the "Proposed Regulation")
RIN1210-AB95

Dear Sir or Madam:

Wellington Management Company LLP ("**Wellington Management**") appreciates the opportunity to comment on the Department of Labor's (the "**Department**") proposed amendments to the "Investment Duties" regulation under Title I of the Employee Retirement Income Security Act of 1974, as amended ("**ERISA**"). Wellington Management is a registered investment adviser organized as a private partnership, privileged to manage over $1.12 trillion in client assets globally across a wide variety of equity, fixed income and asset allocation strategies. As of 30 June 2020, Wellington Management managed approximately $86 billion in United States retirement plan assets subject to the requirements of ERISA and sub-advised $618 billion of United States mutual funds.

We appreciate the Department's efforts to underscore that ERISA fiduciaries must act with "complete and undivided loyalty to the beneficiaries" and that investment decisions should be made solely in the interests of plan participants. We understand that the Proposed Regulation is intended to reinforce these principles by providing guidance on how plan fiduciaries should assess investments with "environmental, social, corporate governance or similarly-oriented characteristics" ("**ESG**"),[1] noting that ERISA prohibits sacrificing plan returns to accomplish "social, environmental or other policy goals."[2] We acknowledge that the core fiduciary requirements of ERISA require plan fiduciaries to act solely in the interests of plan participants and beneficiaries, but we are concerned that the Proposed Regulation, as drafted, will result in adverse consequences for US retirement investors, including reduced investment performance, increased costs, and decreased investment choice.

We urge the Department to reconsider issuing the proposed regulatory changes and instead reiterate that the long-accepted principle under ERISA that a plan fiduciary cannot subordinate the interests of the plan to any other interest apply to ESG and non-ESG investments. In the alternative, we request that the Department revise the proposal to adopt a principles-based approach, eliminating the prescriptive requirements on the investing process – specifically, the limitation on evaluating "non-pecuniary" factors[3] and the requirement, for each investment, to consider available alternative investments.[4] We further request that the Department clearly permit plan sponsors to offer defined contribution plan participants the option to invest in ESG-themed funds without creating new burdens and obligations, so long as the plan participants may choose among a menu of funds with a variety of investment strategies.

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[1] Proposed Regulation at 3-4.
[2] Id., at 4.
[3] Paragraph (c)(1) of the Proposed Regulation.
[4] Paragraph (b)(2)(ii)(D) of the Proposed Regulation.

THE PROPOSED REGULATION COULD HARM PLAN PARTICIPANTS AND BENEFICIARIES

The Proposed Regulation would amend 29 CFR Section 2550.401a-1 ("**Rule 404a-1**"), which was originally adopted in 1979.[5] Its original purpose was to provide plan fiduciaries with a safe harbor for compliance with the "prudence" rule in Section 404(a)(1)(B) of ERISA. In its current form, Rule 404a-1 notes that a plan fiduciary exercising investment duties will have met the requirements of the "prudence rule" where the fiduciary assessing an investment gives appropriate consideration to the salient features of the investment, considering the specific plan client, including the risk of loss and opportunity for gain, and acts accordingly.[6] Thus, Rule 404a-1 provides a principles-based safe harbor that allows plan fiduciaries to make the investment decisions that they believe, as fiduciaries acting solely in the interests of their benefit plan clients, will meet their clients' investment objectives.

We believe that this principles-based approach is appropriate and necessary. Prudent investment management is a complex endeavor. It requires consideration of a mosaic of factors about markets, industries, sectors and individual issuers. In order to make informed investment decisions and to construct portfolios that best meet the anticipated retirement needs of plan participants, portfolio managers of ERISA plan assets must be free to consider potential investments from many different perspectives. For some markets and sectors, portfolio managers may determine factors such as price-to-earnings ratios, revenue growth and divided yield are dispositive. For other types of investments, managers may review creditworthiness, capital structure and prevailing interest rates. More exotic instruments may be evaluated based on factors such as convexity, beta and gamma. Other factors may also play a role, such as anticipated regulatory actions, macro-economic backdrop, anticipated consumer demand, market consumption trends, global weather patterns, etc. Portfolio managers train for years to collect all of this information, assess what is relevant, determine which factors to weigh and which factors to ignore, and ERISA plans retain these managers precisely to benefit from these skills.

We are concerned that the Proposed Regulation would interfere with the ability of investment managers to effectively manage ERISA plans by imposing new restrictions and obligations that are not necessarily reflective of the investment process. Specifically, the Proposed Regulation's treatment of "pecuniary" and "non-pecuniary" factors and the implicit prohibition of consideration of "non-pecuniary" factors, without significant clarification, could create regulatory uncertainty for each investment decision made by a plan fiduciary. Second, the new requirement in the Proposed Regulation for investment managers to compare any investment made for a plan to "available alternative investments," would not always be consistent with the investment process.

"Pecuniary" vs. "Non-Pecuniary" Factors

The Proposed Regulation seeks to discourage plan fiduciaries from considering "non-pecuniary" factors in evaluating an investment for ERISA-covered plans.[7] While we understand the goals of the Department in adopting this requirement, we are concerned that it creates an unworkable standard. First, limiting plan fiduciaries from considering "non-pecuniary" factors establishes an inherently subjective requirement, compliance with which is necessarily an exercise in determining the subjective motivation of the investment decision-maker. For example, a plan fiduciary may, in compliance with the Proposed Regulation, determine not to invest in companies that are polluting due to the potential legal and regulatory exposure created by their pollution. In contrast, the same investment decision (i.e., avoiding polluters) would potentially violate the Proposed Rule if the motivation was a desire to limit pollution. Thus, the same action (avoiding investing in a polluter) could result in compliance or non-compliance with the rule based on the subjective intent of the investment decision maker. Since motivation a subjective factor, it is impossible to prove, and therefore, effective compliance with the Proposed Regulation would be extremely difficult,

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[5] Rules and Regulations for Fiduciary Responsibility, Investment of Plan Assets Under the "Prudence Rule", 44 CFR 37221 at 37222 (1979).

[6] Rule 404a-1

[7] Paragraph (c)(1) of the Proposed Regulation.

especially considering the mosaic of factors portfolio managers may consider in making investment decisions. This challenge will create regulatory uncertainty for investment managers, whether or not they make investment decisions based on ESG factors.

Compounding this regulatory uncertainty is the vague definition of "pecuniary factors".[8] While some factors are clearly "pecuniary" in nature, (e.g., "How much money did the issuer make last year?" or "How much debt does this issuer have?"), it is not at all clear whether other relevant factors would be "pecuniary" or "non-pecuniary", especially those that have a direct or indirect connection to ESG factors, e.g., how a company handles employee morale issues. In fact, many relevant factors could be both "pecuniary" and "non-pecuniary." For example, a travel or transportation company's commitment to reduce its carbon footprint may have positive environmental impacts, but it also may be a tool to reduced costs, attract a new customer base and to better position itself to respond to increasing regulatory pressure. Factors that can be both "pecuniary" and "non-pecuniary" complicate and cloud the compliance analysis for plan fiduciaries. It is unclear how the Proposed Regulation would apply to an investment in an issuer if there are both "pecuniary" and "non-pecuniary" factors in the analysis or if "non-pecuniary" factors may nonetheless be expected to have pecuniary benefits over a longer time horizon.

We fear that this regulatory uncertainty will reduce returns for plan participants and beneficiaries. Plan fiduciaries may seek to mitigate their regulatory and compliance risks by simply avoiding any investment that could be seen to have been motivated by any "non-pecuniary" factors or have ancillary ESG benefits, even when such "non-pecuniary" factors are not relevant to the investment thesis. In addition, plan fiduciaries may feel unable to implement investment ideas that are at all informed by a consideration of ESG factors – even if entirely driven by pecuniary factors.

The Proposed Regulation could also increase costs to plan participants and beneficiaries. Since compliance with the Proposed Regulation requires plan fiduciaries prove the motivation behind their investments, plan fiduciaries may attempt to effect compliance by developing new compliance programs, practices and limitations designed to monitor portfolio manager intent and/or investment evaluation. Such programs would be expensive and these costs would be ultimately borne by plan participants. Even with such systems, because the ultimate determination of compliance with the Proposed Regulation would require a plan fiduciary to prove that its subjective intent was "pecuniary", plan fiduciaries would still be subject to new theories of liability for any investments that do not perform as expected, whether or not those investments were made based on "pecuniary" or "non-pecuniary" factors. For example, a portfolio manager could make an investment in a company that manufactures packaging materials with a higher proportion of recycled materials based, in part, on projections that market demand for materials with higher recycled content will be a positive driver of future earnings, presumably a pecuniary factor under the Proposed Regulation.[9] However, we are concerned that the Proposed Regulation would create the possibility for a plan fiduciary making such a decision to be second-guessed and subject to new potential liability should this investment underperform.

The Requirement to Consider Available Alternative Investments Should be Removed

The Proposed Regulation includes a new requirement that plan fiduciaries to compare investments or investment courses of action to other available investments or investment courses of action.[10] As drafted, this new requirement

[8] The Proposed Regulation does not affirmative define "pecuniary", so for the purposes of this letter, we are using the definition of "pecuniary" as "of or relating to money" ("pecuniary." Merriam-Webster.com. Retrieved 20 July 2020, from https://www.merriam-webster.com/dictionary/pecuniary).

[9] Of course, this factor would be considered alongside a much larger mosaic of factors, which may include obviously pecuniary factors such as market prices, forward earnings, etc., but also may include factors that are less obviously pecuniary, such as whether the company has separated the roles of board chairman and chief executive officer.

[10] Paragraph (b)(2(ii)(D) of the Proposed Regulation.

appears to apply to **all** investment decisions, regardless of whether ESG factors are implicated.[11] A new requirement of this scope will be impractical and costly to implement.

A comparison of alternative investments is not always a relevant framework for analyzing potential investments. For any investment decision made by a plan fiduciary, there are an unlimited number of alternatives investment decisions a fiduciary could make, and the Proposed Regulation does not circumscribe the universe of alternatives that a fiduciary would be required to consider. Even with a circumscribed universe of alternatives, not all investments are made based on relative attractiveness; investing is not necessarily a collection of "either/or" decisions. In some instances, investments are based on availability in the market rather than a favorable evaluation against the alternatives. In other instances, there are no reasonable alternatives, or, on the other hand, any alternative will suffice.

We are concerned that requiring plan fiduciaries to conduct an evaluation of investment alternatives for all investments, even where unnecessary from an investment perspective, will negatively impact investment returns for plan participants and beneficiaries while also increasing their costs. First, requiring portfolio managers to conduct analysis that is unnecessary will take up time that they could deploy in analyzing new investment opportunities. In addition, the time it would take to perform this unnecessary evaluation will delay the implementation of investment decisions, potentially harming returns. Costs to plan participants and beneficiaries would increase because, plan fiduciaries would be required to establish and implement entirely new policies, procedures and processes to ensure investment professionals were performing this otherwise unnecessary analysis.

The Department Should Adopt a Principles-Based Approach.

Given the existing regulatory regime, we do not believe the changes set forth in the Proposed Regulation are necessary. Section 404(a)(1) of ERISA currently imposes a duty of loyalty on plan fiduciaries that requires them to act "solely in the interest of the participants and beneficiaries" and "for the exclusive purpose of" providing benefits and defraying expenses of the plan. We believe the Department could accomplish its goals by merely reiterating (and not changing) this long held standard.

Should the Department determine that new regulations are necessary, we submit that the Department should adopt a more principles-based approach. We strongly believe that investment professionals and plan fiduciaries are best situated to determine which factors are relevant to an investment and how to weigh those factors, and that these investment professionals should not be limited in the scope of factors they may consider in making investment decisions for their ERISA clients, so long as they act consistently with the requirements of Section 404 of ERISA. To that end, we submit that the Department should remove (i) the prohibition that would limit evaluation of an investment solely to "pecuniary factors" and (ii) the requirement to assess "available alternatives" and allow plan fiduciaries the latitude to discharge their investment management obligations in the best interests of plan beneficiaries and consistent with the requirements of Section 404 of ERISA.

ESG OPTIONS ON DEFINED CONTRIBUTION PLAN MENUS

We appreciate the Department seeking to provide clarity to individual account plan sponsors with respect to including ESG-related options for plan participants. We understand from discussions with our clients who sponsor retirement plans that many plan participants would appreciate the option to invest in ESG-themed or ESG-focused investment funds. Thus, we appreciate the Department's clarification that a "prudently selected, well managed and properly diversified fund with ESG investment mandates could be added to available investment options on a 401(k) plan" without requiring the plan to forego non-ESG themed options.

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[11] Id. We note that it is not clear that the Department intends for this requirement to apply so broadly, as discussion in the preamble to the Proposed Regulation focuses only on the application of this standard in the context of ESG-related investments.

We are concerned, however, that the Proposed Regulation sets forth requirements that create new burdens and regulatory risks that may lead plan fiduciaries to avoid including such options. First, we are concerned that the new documentation requirement applicable to ESG-themed funds is overly burdensome and unnecessary.[12] As noted by the Department, plan fiduciaries already maintain documentation about their investment choices, so the new requirements with respect to ESG-themed funds create new technical requirements that increase the risk of liability for plan fiduciaries without providing any new benefits to plan participants. We further note that such additional documentation is not required with respect to the consideration any other factors. We are concerned that this unnecessary requirement will discourage plan fiduciaries from meeting the demands of plan participants by offering ERG-themed funds. Instead, we believe that fiduciaries who want to offer such options will of be forced to offer brokerage accounts, which are more expensive for plan participants and provide less investment support.

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We appreciate the opportunity to comment on the Proposed Regulation. If you have any questions, please contact me, Wendy Cromwell, Director of Sustainable Investments, or Lance C. Dial, Managing Director and Counsel at the above number.

Sincerely,

Mary Pryshlak
Head of Investment Research

[12] Section (c)(3)(ii) of the Proposed Regulation.