The SPARK Institute, Inc.
SHAPING AMERICA'S RETIREMENT

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

Dear Sir or Madam:

On behalf of the SPARK Institute, Inc., we are writing to provide comments on the amendments proposed by the Department of Labor (the "Department") to the "Investment Duties" regulation under the Employee Retirement Income Security Act of 1974 ("ERISA").[1]

The SPARK Institute appreciates the Department's goal of providing regulatory clarity and certainty with respect to the duties of a fiduciary when selecting investments and investment courses of action for a plan, including with respect to environmental, social, and corporate governance ("ESG") considerations. As discussed below, however, we have significant concerns that, rather than simply clarifying and codifying a fiduciary's duties of prudence and loyalty to participants and beneficiaries relative to ESG considerations, the proposed amendments would have unanticipated and far-reaching adverse consequences for participants, plans, and their service providers. Due to the very unexpected broad scope of the proposed changes and the concerns they raise, we urge the Department to carefully consider these consequences and take steps to ameliorate them prior to finalizing any changes to the existing Investment Duties regulation.

The SPARK Institute represents the interests of a broad-based cross section of retirement plan service providers and investment managers, including banks, mutual fund companies, insurance companies, third party administrators, trade clearing firms, and benefits consultants. Collectively, our members serve approximately 95 million employer-sponsored plan participants.

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[1] 85 Fed. Reg. 39,113 (June 30, 2020).

In Part I below, we offer general comments on the Department's proposed amendments to the Investment Duties regulation. In Part II, we describe specific concerns that our members have with the proposed amendments.

I. General Comments on Amending the Investment Duties Regulation

Plan sponsors, fiduciaries, and service providers have relied on the existing Investment Duties regulation for more than 40 years. Due to the evolution in investing that has occurred during that period, we support the Department's initiative to review the existing regulation and determine whether any changes may be warranted. That being said, the duties that ERISA imposes on investment fiduciaries have withstood the test of time. This has been possible because the statute's non-prescriptive approach facilitates the application of ERISA's core fiduciary principles in any number of situations, including ones that could not have been envisioned at the time of enactment. In this regard, the SPARK Institute's members have generally found that the Investment Duties regulation has, like the statute, also successfully provided a framework that is protective of participants and beneficiaries despite changes in investment options and approaches over the years.

Importance of a prudent process. One of the core aspects of ERISA's fiduciary provisions and the Department's existing Investment Duties regulation is the concept that a fiduciary must engage in a prudent process when making investment decisions on behalf of a plan. The SPARK Institute agrees that engaging in and maintaining a prudent process is of utmost importance. As explained below in Part II, our concerns with the proposed amendments stem primarily from our belief that the proposed changes would interfere with, as opposed to promote and ensure, a fiduciary's ability to follow a prudent process when making investment decisions.

Proposed amendments far exceed codification of existing guidance. The Department states in the preamble to the proposed amendments that it is seeking to reiterate and codify its longstanding position regarding the scope of fiduciary duties with respect to non-pecuniary issues.[2] If that were the sole impact of the proposed amendments (i.e., clarifying what is already widely understood by plan fiduciaries in light of existing sub-regulatory guidance), then this would be a short letter. However, as described in more detail in Part II of our letter, we are very concerned that the effect of the proposed amendments would go far beyond simply codifying what the Department describes as its longstanding position. It is further unclear to us whether the Department intended for its proposed amendments to have such far-reaching implications.

Recommendation to limit overly broad consequences. If the Department's sole intention with the proposed amendments is to codify its longstanding position related to ESG

[2] *Id.* at 39,116.

considerations,[3] then we suggest that the Department could accomplish this goal in a much simpler manner and without raising many of the concerns that we have described below in Part II.[4] For example, we suggest that the Department could simply make the following two amendments to the existing Investment Duties regulation: (1) add a restatement of ERISA's exclusive purpose rule and (2) add a statement clarifying the Department's key point that a fiduciary does not satisfy the exclusive purpose rule if the fiduciary subordinates the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to unrelated objectives, or sacrifices investment return or takes on additional investment risk to promote goals unrelated to those financial interests of the plan's participants and beneficiaries or the purposes of the plan.

We find the other amendments proposed by the Department to be largely superfluous and unnecessary in codifying the Department's key point regarding ESG considerations, and, as described below, the other proposed changes are the primary source of the SPARK Institute's concerns with the entire proposal due to their vast implications and complications. We believe that the two additions suggested above would capture the Department's stated goals and serve to remind fiduciaries that they must not subordinate participants' and beneficiaries' interests in their retirement income to other interests that do not further that goal.

Need for a more robust regulatory process and economic analysis. The sweeping implications of the proposed amendments warrant a robust and data-driven justification for taking such regulatory action. They also require a more thorough economic analysis that accounts for the many implications we describe in Part II below. But the justification the Department describes for the proposed amendments in the preamble falls far short of what would be sufficient for changes that are as substantial as those now being proposed. For example, the preamble notes in multiple places that certain activities the Department is concerned about "may" be occurring, but the preamble lacks data showing that such concerns are in fact occurring. The preamble similarly lacks data regarding the magnitude of any perceived or identified problems.[5] Furthermore, the Department seems very unsure of the benefits of its

[3] The Department describes its longstanding position as follows: "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." 85 Fed. Reg. 39,116.

[4] The Department states in its Regulatory Impact Analysis that it solicits comments on all alternatives. In connection with describing the alternatives that the Department has already considered, the Department states that it believes the approach reflected in the proposed amendments "best reflects the statutory obligations of prudence and loyalty, appropriately ensures that fiduciaries' decisions will be guided by the financial interests of the plans and participants to whom they owe duties of prudence and loyalty, and is the easiest to apply and enforce." 85 Fed. Reg. 39,123. We believe our recommended alternative would be vastly easier to apply and enforce, while still reflecting fiduciaries' obligations to participants.

[5] For example, the Department notes in the preamble that what it considers a growing emphasis on ESG investing "may" be prompting ERISA fiduciaries to make investment decisions for purposes other than providing benefits to participants and beneficiaries. The Department expresses additional concern that some investment products "may" be marketed to ERISA fiduciaries on the basis of purported benefits and goals unrelated to financial performance. 85 Fed. Reg. 39,116. In neither case does the Department cite evidence that such concerns are

proposed amendments, simply stating that the Department "anticipates" that the benefits will be "appreciable," and asking for information that could be used to quantify the increase in investment returns by a reduced use of non-pecuniary factors.[6]

The SPARK Institute thus urges the Department to carefully consider the full implications of the proposed amendments before finalizing any changes, both with respect to their impact on ESG considerations and with respect to the more wide-ranging implications of the proposal as discussed within this letter.

II. <u>Specific Comments on the Proposed Amendments</u>

The SPARK Institute has the following comments, questions, and concerns with respect to specific aspects of the Department's proposed amendments to the Investment Duties regulation.

a. The lack of a definition of "ESG" creates untenable ambiguities regarding how broadly the proposed amendments would apply to various investment options.

The Department states in the preamble that the proposed amendments are designed in part "to make clear that ERISA plan fiduciaries may not invest in ESG vehicles when they understand an underlying investment strategy of the vehicle is to subordinate return or increase risk for the purpose of non-pecuniary objectives."[7] Critically, the proposed amendments very conspicuously fail to define "ESG," "ESG vehicle," "ESG consideration," or any other similar term. Nor do the proposed amendments define "environmental," "social," or "corporate governance," or give any guidance on what might be "similarly oriented assessments or judgments." This leaves fiduciaries in the very undesirable position of being unable to determine exactly what the Department seeks to regulate and the scope of that regulation, and it opens the door to expensive litigation that seeks to exploit those ambiguities.

As noted by the Department, various terms have been used to describe ESG-type and related investment behaviors, and such terms do not yet have a uniform meaning.[8] This makes it even more critical that the Department define what it means when it refers to ESG within the context of the regulation or other guidance. The absence of a definition is a very basic concern that affects all aspects of the proposed amendments to the Investment Duties regulation. Depending on how the term (or scope of its usage) is ultimately defined, many of the other concerns we identify below could be either substantially heightened or partially mitigated.

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justified or are, in fact, harming participants and beneficiaries. To the contrary, the evidence the Department cites largely relates to investing outside of the U.S. or outside of ERISA-governed plans.

[6] 85 Fed. Reg. 39,121.

[7] *Id.* at 39,116.

[8] *Id.* at 39,114.

Without a definition of ESG in the proposed amendments, it is impossible, for example, for the SPARK Institute's members to determine how broadly the requirements that apply with respect to ESG considerations must be applied. For example:

- If a fiduciary determines that two investment alternatives are "economically indistinguishable," do the additional documentation requirements in proposed new paragraph (c)(2) apply only if one (or both) of the alternatives uses "ESG" in its name? Or would the documentation requirements apply if one of the alternatives prominently describes itself as an ESG fund? Or by some other standard?
- If the investment manager of a fund that a fiduciary is evaluating takes ESG considerations into account on rare occasions but otherwise does not purport for the fund to be an ESG fund, is the fiduciary prohibited from selecting that fund as the plan's QDIA?
- How would the proposed amendments apply when a plan fiduciary is evaluating a fund of funds, including a target date fund, where some of the component funds might possibly account for ESG factors?
- How much investigation is required by a fiduciary in order to determine whether an investment fund meets whatever definition of "ESG" may apply? Is it sufficient to look only to the fund name and/or investment disclosures, or must a fiduciary conduct additional investigations or inquiry?

The answers to these and other similar questions are enormously important in evaluating and understanding the true scope and impact of the proposed amendments, including the cost of complying with such changes. For example, if the Department clarifies that it intends for "ESG" to apply narrowly, such as with respect to only those investment alternatives that prominently call themselves an "ESG," "socially responsible," or similar option,[9] then the impact and associated burdens of the proposed regulations may be more measured. However, if the Department intends to sweep in a much broader set of investment alternatives under the umbrella of "ESG," then the resulting impact, burden, expense, and collateral consequences of the proposed amendments could be tremendous. For example, a fiduciary or investment manager may be forced to continuously monitor plan and/or fund investments for the potential need to divest any portions that could now or later be viewed as including an ESG factor. Another consequence, as noted above, would be an increased risk of litigation for plan fiduciaries, for whom a broad definition of ESG could make their tasks virtually impossible.

[9] In the preamble to the proposed amendments, the Department states that fiduciaries considering investment alternatives for individual account plans "should carefully review the prospectus or other investment disclosures for statements regarding ESG investment policies and investment approaches." 85 Fed. Reg. 39,118. Although this suggests that fiduciaries would be required to look beyond the name of an investment alternative to determine if it falls under the umbrella of "ESG," it also fails to confirm whether a review of the investment's prospectus and investment disclosures would be sufficient. Further, if a disclosure includes a statement, for example, that the fund manager may take governance factors into consideration, it may be impossible for a fiduciary to determine whether the fund manager believes those governance factors have a material impact on the risk and/or return of the particular investment, or if she is doing so to further unrelated social goals.

If the Department proceeds with amending its Investment Duties regulation, then we urge the Department, as a starting point, to provide a workable definition of "ESG" (or similar term) that will make it possible for fiduciaries to comply with any new requirements that may apply to such investments. And, if the Department defines "ESG" in a broad manner such that it would apply to investment alternatives beyond those that prominently claim to be an ESG investment, then we urge the Department to seek public comments on any such definition prior to finalizing any regulations in order to better understand the potential implications of the changes.

b. The proposed amendments improperly equate ESG considerations with non-pecuniary considerations.

Paragraph (c)(3) of the proposed amendments places special burdens on plan fiduciaries of a defined contribution plan whenever the fiduciary includes, in the plan's menu, any "investment alternatives that include one or more environmental, social, corporate governance, or similarly oriented assessments or judgments in their investment mandates." Under the proposal, however, this is the case *whether or not such assessments or judgments are based on pecuniary factors*. In fact, many of the factors investment managers use in making investment decisions, which reasonably could be called "environmental, social, or corporate governance" factors, are decidedly pecuniary in nature. For example, any investment manager evaluating a portfolio company would be foolish not to consider whether the company's corporate governance and compensation policy aligns with the goals of shareholders. An investment manager investing in the energy sector could be expected to hedge investments in fossil fuels with investments in renewable energy because these are countercyclical. And it would be unsurprising for an investment manager to look very carefully at a company's record with respect to discrimination lawsuits before investing in that company.

Put another way, the proposed amendments assume (with no justification in the preamble that we can discern) that "ESG" factors by their nature do not impact investment outcomes and thus must be subject to special scrutiny. Some ESG factors certainly will have a material impact on investment returns, others will not, and prudent investment managers will, of course, disagree about which is which. We fear that placing special burdens on particular investment judgments will have exactly the opposite effect the Department intends: the regulation will subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to unrelated objectives, or sacrifice investment return to promote unrelated goals.

c. A sole focus on "pecuniary" and objective factors ignores other aspects of a prudent investment evaluation process.

The proposed amendments emphasize that a fiduciary's evaluation of an investment "must be focused only on pecuniary factors." The Department proposes to define the term "pecuniary factor" in part as "a factor that has a material effect on the risk and/or return of an investment." Similarly, the proposed amendments would allow a fiduciary to add an investment that includes ESG assessments or judgments as a designated investment alternative to an individual account plan, but only if the fiduciary "uses only objective risk-return criteria."

SPARK Institute members have voiced concern that the proposed amendments' sole focus on pecuniary factors and objective criteria will have an impact that goes far beyond the Department's stated goal of clarifying that fiduciaries may not subordinate participants' interests in their retirement income to ESG considerations. Although pecuniary factors, as the proposal has defined them, are certainly heavily weighted when evaluating investment options, investment managers and fiduciaries routinely take into consideration a variety of factors that do not necessarily have a "material effect on the risk and/or return" on a particular investment. For example, a plan committee may consider a fund manager's brand or reputation when determining whether to include that fund in the plan's menu. Or, a fiduciary may account for operational considerations when selecting one investment fund over another, where those operational considerations may have bearing on the fees borne by participants or the smooth operation of the plan. A fiduciary might decide to choose an investment regulated in one legal regime over another because of the protection the fiduciary believes the particular regulatory regime offers, or it might find the disclosures produced by one investment provider easier for participants to understand. In effect, the proposed amendments incorrectly presume that a fiduciary's evaluation of investment options may be reduced to a simple mathematical equation where it is known with certainty which factors will have a "material effect on the risk and/or return of an investment." But it would not be inconsistent with a prudent process to allow for the consideration of other nuances to the extent that a fiduciary finds them meaningful to a thorough evaluation of an investment. ERISA is clear on this point: the question is whether a particular factor would be taken into account by "a prudent man acting in a like capacity and familiar with such matters . . . in the conduct of an enterprise of a like character and with like aims."

The SPARK Institute is also concerned that the proposed amendments' focus on objective factors would inappropriately disfavor actively managed investments relative to passive investments, simply because a fiduciary must always assure itself that an active manager makes each and every decision based on pecuniary factors. The Department even describes in its regulatory impact analysis that one anticipated benefit of the proposed amendments is that plans will "invest less in actively managed ESG mutual funds" and may instead "select mutual funds with lower fees or passive index funds."[10] The SPARK Institute's members collectively offer a variety of low cost active and/or passive funds, and existing fiduciary processes are perfectly capable of evaluating the pros and cons of different investment strategies.

SPARK Institute members have expressed similar concerns about the impact of the proposed amendments on the use of proprietary funds or employer stock within a plan's investment lineup. The proposed amendments call into question a long history of permitting certain collateral benefits with respect to the selection of an investment as long as a fiduciary engages in a prudent process and acts in accordance with his or her duties to participants. Worse

[10] 85 Fed. Reg. 39,121.

yet, we fear the proposal will have the unintended effect of making it much easier for class action plaintiffs to bring baseless litigation to secure quick settlements.

We urge the Department to remove the proposal's requirement that only pecuniary factors (as defined by the proposal) may be considered, thereby permitting the consideration of non-pecuniary factors and pecuniary factors that do not have a material effect on the risk and/or return of an investment, provided that the consideration of such factors is made as part of a prudent process a fiduciary uses and is consistent with the fiduciary's duties of prudence and loyalty. We further ask that the Department clarify that the proposal is not intended to affect existing guidance that permits such considerations when made in connection with a prudent process.

d. A requirement to compare available alternative investments without limit would be effectively impossible and would create enormous administrative burdens.

Under the existing Investment Duties regulation, a fiduciary is required to consider, at a minimum, the following three factors in order to satisfy the requirement to give "appropriate consideration" to the facts and circumstances that are relevant to a particular investment or investment course of action: (1) the composition of the portfolio with regard to diversification; (2) the liquidity and current return of the portfolio relative to the anticipated cash flow requirements of the plan; and (3) the projected return of the portfolio relative to the funding objectives of the plan. The Department has proposed to add a fourth factor to paragraph (b)(2): how the investment or investment course of action "compares to available alternative investments or investment courses of action" with regard to the existing three factors.

Similarly, proposed new paragraph (c)(1) (*Consideration of Pecuniary vs. Non-Pecuniary Factors*) would require fiduciaries considering ESG or other similarly oriented factors as pecuniary factors to "examine the level of diversification, degree of liquidity, and the potential risk-return *in comparison with other available alternative investments* that would play a similar role in their plans' portfolios" (emphasis added).

In the preamble, the Department states that clarifying within paragraph (b)(2) the need to compare available alternatives is "an important reminder that fiduciaries must not let non-pecuniary considerations draw them away from an alternative option that would provide better financial results."[11] With respect to proposed new paragraph (c)(1), the Department similarly states that "fiduciaries' consideration of ESG factors must be focused on their potential pecuniary elements by requiring fiduciaries to examine the level of diversification, degree of liquidity, and the potential risk-return profile of the investment *in comparison with available alternative investments* that would play a similar role in their plans' portfolios" (emphasis added).[12]

[11] *Id.* at 39,117.

[12] *Id.*

As stated above, the SPARK Institute and its members believe it is imperative that fiduciaries utilize a prudent process when making investment decisions with respect to a plan. We are not suggesting that an investment decision does not necessarily involve forgoing alternative courses of action. But precisely what a prudent process looks like with respect to any given investment decision will inevitably vary based on the specific facts and circumstances of a situation, including the costs to make those comparisons. Although we expect that a prudent process would typically include the consideration of other available investment alternatives, the scope of such comparisons may vary significantly based on the situation.

The SPARK Institute's members are very concerned that the Department's proposed requirement to make a comparison with other available alternative investments could be interpreted so broadly as to suggest that a fiduciary must conduct a comparison with *every* available alternative. Such a requirement would be cost-prohibitive, if not plain impossible to comply with. This is another instance in which we are concerned that the proposed regulations will invite **unwarranted litigation** against plans, because a requirement to exhaustively compare investment alternatives is an impossible standard to meet. And a creative class plaintiffs' attorney can always find *some* alternative that outperformed the investment chosen or had lower costs.

The core requirement that fiduciaries follow a prudent process when making investment decisions already incorporates the consideration of alternatives to the extent warranted by the particular facts and circumstances involved. We urge the Department to reconsider the need to explicitly incorporate a requirement to compare investment alternatives in the Investment Duties regulation. Alternatively, at a minimum, we ask the Department to clarify that the scope of the required comparison depends on the facts and circumstances and will be evaluated using a prudent person standard.

e. The proposal conflates a fiduciary's duties of prudence and loyalty.

The existing Investment Duties regulation restates a fiduciary's duty of prudence under section 404(a)(1)(B) of ERISA and then specifies a number of actions a plan fiduciary must take in order to satisfy that duty when making an investment decision.[13] The Department has proposed to add to the regulation a restatement of ERISA's exclusive purpose requirements in section 404(a)(1)(A), which is generally considered as embodying a fiduciary's duty of loyalty.

The SPARK Institute supports the incorporation of the duty of loyalty within the Investment Duties regulation as a reminder and emphasis that fiduciaries must keep such duty in mind when making investment decisions on behalf of participants and beneficiaries. However, we are concerned about the manner in which the proposed amendments would effectively combine the duties of prudence and loyalty, implying that the same actions are required in the satisfaction of both duties.

[13] 29 C.F.R. § 2550.404a-1(a), (b).

For example, under the proposal, a fiduciary's duties of prudence *and* loyalty are not satisfied unless the fiduciary takes into consideration the diversification of the portfolio. That requirement clearly applies to acting prudently, but it has no bearing on whether a fiduciary met his or her duty of loyalty. However, if a fiduciary fails to consider the diversification of a portfolio, then the proposed amendments would provide that the fiduciary has violated *both* the duties of prudence and loyalty. We do not believe that this result is appropriate, and we encourage the Department to make clear within any amendments that there is generally a separation between the actions required in support of each respective fiduciary duty. This could be accomplished, for example, by revising the proposed amendments by removing the reference to section 404(a)(1)(A) of ERISA in paragraph (b)(1) and replacing paragraphs (b)(1)(ii), (iii), and (iv) with a separate paragraph (such as (b)(3)) stating that the requirements of section 404(a)(1)(A) of ERISA are satisfied if the fiduciary has not subordinated the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to the fiduciary's or another's interests or to unrelated objectives.

f. The proposed amendments would inappropriately disfavor, as opposed to neutralize, investments with ESG considerations and interfere with a fiduciary's ability to follow a prudent process.

Under paragraph (c)(2) of the proposed amendments, in the case of "economically indistinguishable" alternative investments, a fiduciary may select an investment based on ESG considerations but "should" document why the investment was economically indistinguishable and why it was selected. The Department explains in the preamble that this documentation requirement is intended "simply to confirm" a fiduciary's general practice of maintaining such documentation, but also to "provide a safeguard" against the risk that fiduciaries will make decisions based on non-pecuniary factors.[14] Similarly, the proposed amendments would allow a fiduciary to add an investment with ESG considerations to a plan's investment platform if, among other requirements, the fiduciary documents its selection and monitoring of the investment in accordance with his or her use of objective risk-return criteria.

We appreciate the Department's desire to focus on the primacy of a fiduciary's consideration of pecuniary factors as part of ensuring that a fiduciary's actions are consistent with the duty of loyalty. However, we are concerned that the additional requirements the proposed amendments would place on fiduciaries who select an investment with ESG considerations would go far beyond simply neutralizing investments with ESG considerations and would instead actively discourage their use. This is problematic because it will have the effect of discouraging fiduciaries from *ever* considering investments with ESG considerations due to concern over the additional administrative burdens, even if such an investment may have ultimately been in the best interest of participants. And even if a fiduciary does consider an ESG investment, the proposed amendments would discourage the selection of that investment in connection with the proposal's tie-breaking process. In this regard, the proposed amendments

[14] 85 Fed. Reg. 39,117-18.

very concerningly deviate from ERISA's core standard that fiduciaries must follow a prudent process because the proposal would dictate what that prudent process may or may not look like.

The SPARK Institute believes that the existing responsibility that fiduciaries have to follow a prudent process when making investment decisions already accounts for the type of documentation that the Department proposes to codify in the regulations. As noted above, the Department even acknowledges as much in the preamble. As such, codifying a specific documentation requirement in the Department's regulations, especially where those requirements single out certain types of investments, would not further enhance the responsibilities that fiduciaries have to follow a prudent process. Instead, as noted above, it would introduce new disincentives for fiduciaries to abide by a prudent process and unfairly disfavor – as opposed to simply neutralize – certain investments. Alternatively, the proposed amendment could be interpreted as suggesting that such heightened documentation requirements apply with respect to *all* investment decisions, which would only further increase the new burdens and expenses on plans. In light of this range of potential consequences, and consistent with our recommendation as described above in Part I (see "Recommendation to limit overly broad consequences"), we suggest that the Department could eliminate proposed paragraphs (c)(1), (2), and (3) while still accomplishing the Department's stated objectives *and* preserving a fiduciary's ability to engage in a prudent evaluation process.

g. The proposed amendments would prohibit fiduciaries from taking into account participant investment preferences, which could discourage saving for retirement.

In Field Assistance Bulletin ("FAB") 2018-01, the Department states the following:

> In the case of an investment platform that allows participants and beneficiaries an opportunity to choose from a broad range of investment alternatives, adding one or more funds to a platform in response to participant requests for an investment alternative that reflects their personal values does not necessarily result in the plan forgoing the placement of one or more other non-ESG themed investment alternatives on the platform. Rather, in such a case, a prudently selected, well managed, and properly diversified ESG-themed investment alternative could be added to the available investment options on a 401(k) plan platform without requiring the plan to forgo adding other non-ESG-themed investment options to the platform.

A related footnote in FAB 2018-01 further clarifies that "a plan fiduciary could adopt an investment policy statement with prudent criteria for selection and retention of designated investment alternatives for an individual account plan that were based solely on economic factors, and apply that policy to all investment options, including potential ESG-themed funds."

Noticeably absent from the Department's proposed amendments to the Investment Duties regulation is any similar clarification that fiduciaries may take participant preferences into account when selecting the designated investment alternatives for a plan. Instead, the language of the proposed amendments appears to prohibit fiduciaries from ever considering participant preferences in the selection of a designated investment alternative, even if the fiduciary otherwise follows a prudent selection process. Although some participants may express the desire for an ESG-themed investment option, there are a range of other requests that participants may express with respect to their investment choices, and the proposed regulation appears to prohibit consideration of any such preferences.

The SPARK Institute encourages the Department to retain the guidance in FAB 2018-01 that allows fiduciaries to consider participant preferences within certain parameters. If a plan participant has a strong desire or conviction to fully (or partially) avoid investing in certain types of funds, then the only options that individual will have under the proposed amendments are to (1) use a brokerage window (if available), where there is no fiduciary oversight of the available ESG funds, (2) not save at all (or save less) through the plan, or (3) select plan investment options that are otherwise not ideal for a participant's particular situation (e.g., invest only in bond funds to avoid the plan's only available equity funds). None of those options will be ideal.

The Department acknowledges the above concern in the preamble, stating that the removal of an ESG fund from a plan's investment menu followed by the decision not to replace such fund with a similar ESG option in light of the Department's proposed amendments "could be disruptive." The Department justifies its proposal, however, by adding that "similar disruptions occur when plan fiduciaries routinely change designated investment alternatives."[15] We note that the substitution of one investment option for another in a plan's investment menu typically involves the replacement of one fund with a very similar one, such that most participants would have little or no concern with the change. Participants with an expressed preference to invest in an ESG fund may have much stronger concerns, forcing a choice among the three options described in the preceding paragraph.

h. The proposed amendments' restrictions on QDIA investments would interfere with a fiduciary's ability to engage in a prudent process and act in participants' best interests.

The proposed amendments would prohibit an "environmental, social, corporate governance, or similarly oriented investment mandate alternative" from being added as a plan's qualified default investment alternative ("QDIA"), or as a component of a QDIA. The Department explains its reasons for this prohibition in the preamble, indicating that the selection of an investment fund as a QDIA "is not analogous to merely offering participants an additional investment alternative" due to the liability relief provided to fiduciaries with respect to QDIAs by ERISA and the QDIA regulations.[16] The Department further states that it does not believe

[15] 85 Fed. Reg. 39,122.

[16] *Id.* at 39,119.

that investment funds whose objectives include non-pecuniary goals should be a QDIA "*even if* selected by fiduciaries only on the basis of objective risk-return criteria," and that the proposed requirement is intended to "help ensure that the financial interests of plan participants and beneficiaries in retirement benefits remain paramount" (emphasis added).[17] The Department likens the proposed prohibition to the existing rule that a QDIA may not hold or permit the direct acquisition of employer securities.

The SPARK Institute is very concerned that a blanket prohibition on selecting an investment option with ESG considerations as a QDIA would be contrary to participants' interests and is unnecessary in achieving the stated goals of the Department. First, it is possible that a fiduciary could, after following a prudent process that examines investment alternatives based only on pecuniary factors, determine that an investment option that includes ESG-related assessments or judgments is the best option to serve as the QDIA. But under the proposed amendments, the fiduciary would be prohibited from selecting that best option as the QDIA.

Second, the proposed amendments would unnecessarily single out QDIAs as requiring a higher level of fiduciary oversight. If a fiduciary is inappropriately placing his or her own policy preferences above the interests of participants, then we would view that as a violation of the fiduciary's duties under ERISA and the Department's existing guidance, and not as a sign of a defect or hole in existing guidance.

Third, some of our members have noted that the direction the proposed amendments would take with respect to QDIAs appears to be inconsistent with other efforts the Department has made to expand the availability of different investments as a QDIA. Placing a wholesale prohibition on funds with ESG considerations being selected as a QDIA would be taking a step backward in this regard. As noted above, we believe that appropriate safeguards are already in place, and following those existing safeguards means that an investment option with ESG considerations would not be selected as a QDIA unless the fiduciary, following a prudent process, determines that it is the best option for the plan.

Finally, we note that, to the extent the Department proceeds with any new restrictions or other guidance on QDIAs, we recommend that the Department consider making such changes directly to the QDIA regulation via notice and comment rulemaking, and not within the Investment Duties regulation. It would be an odd and inappropriate result for an investment to satisfy the requirements of being a QDIA under the QDIA regulations, only to be excluded by a prohibition that is applicable only to QDIAs under another regulation (e.g., an amended Investment Duties regulation). The proposed amendments, however, would inevitably produce that result. We also request that the Department delay the effective date of any such changes in order to give plans sufficient time to comply.

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[17] *Id*.

The SPARK Institute appreciates the opportunity to provide these comments to the Department. If the Department has any questions or would like more information regarding our comments, please contact me or the SPARK Institute's outside counsel, Michael Hadley, Davis & Harman LLP (mlhadley@davis-harman.com).

Sincerely,

Tim Rouse
Executive Director