July 30, 2020

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)

To the Employee Benefits Security Administration:

Based on my knowledge and experience with respect to the issue of fiduciary duty raised by the above-referenced proposed regulations I write as follows in opposition to those regulations.[1]

Reprise of relevant aspects of the regulations

In draft section (b)(1(i), the Department delineates the "investment duties" of fiduciaries, namely, requiring a fiduciary, in his or her "consideration of an investment or investment course of action" give "appropriate consideration to those facts and circumstances….relevant to the particular investment or investment course of action involved" paragraph (b)(1)(i) and "evaluate[] investments and investment courses of action based solely on pecuniary factors that have a material effect on the return and risk of an investment based on appropriate investment horizons and the plan's articulated funding and investment objectives." paragraph (b)(1)(ii). More specifically, in paragraph (b)(1)(ii)(D) the Department requires a fiduciary, in consideration of an investment or investment course of action, to "compare [it] to available alternative investments or investment courses of action" with regard matters of diversification, liquidity, return, and cash flow, and projected return in relation to the funding objectives of the plan. See section (b)(1)(ii)(A)-(C).

In paragraph (c)(1), the Department arguably returns to the point. First, it broadly requires that a fiduciary's investment decisions "must be focused only on pecuniary factors". The Department next fleshes out the meaning of that requirement, barring from "sacrific[ing] investment return or tak[ing] on additional investment risk to promote non-pecuniary benefits or any other non-pecuniary goals." The Department then immediately follows with the assertion that "[e]nvironmental, social, corporate governance, or other similarly oriented considerations are pecuniary factors only if they present economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories." Note that in provision the Department changes its language from that of paragraph (b)(1)(i), referring to "material economic considerations" rather than "a material effect on the return and risk of an investment".

The Department then adds in language echoing but not quite the same as that of paragraph (b)((1)(II)(A)-(C) that "[f}iduciaries considering environmental, social, corporate governance, or other similarly oriented factors as pecuniary factors are also required 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."

Lastly, in paragraph (c)(2) the Department speaks to a case in which pursuant to the foregoing prescription a fiduciary evaluates a particular investment on "the basis of a non-pecuniary factor or factors such as environmental, social, or corporate governance considerations" and compared it with alternative investments that would play a similar role in their plans' portfolios and has concluded that it is "economically indistinguishable" the other(s) as characterized (as provided for by paragraph (c)(1) by "the level of diversification, degree of liquidity, and the potential risk-return". The section requires documentation by the fiduciary with respect to that conclusion. According to the Department's explanation for the proposed regulations this is corresponds so-called "break a tie" scenario articulated in prior Department guidance and hence, the assumption is that an affirmative conclusion would allow the fiduciary's selection of the particular investment. That being said, the Department immediately acknowledges that the occurrence of such a scenario is a rare one, if even that. Nonetheless, the Department does not abandon it. Rather, expressing concern that the test can be gamed and its inability to determine so simply appeals to interested parties for a means to solve the problem the Department has created for itself.

Next, in draft paragraph (c)(2) the Department provides that "[w]hen alternative investments are determined to be economically indistinguishable…. and one of the investments is selected on the basis of a non-pecuniary factor or factors such as environmental, social, or corporate governance considerations (notwithstanding the requirements of paragraph (b) and paragraph (c)(1)), the fiduciary should document specifically why the investments were determined to be indistinguishable and document why the selected investment was chosen.

Comments

The Department's formulation raises concerns about how well informed it is with regard to the investment-decision making practices it seeks to regulate; and arguably as a related matter, the draft regulations lack coherence and needed specificity.

With regard to the first point, whatever its appeal to some of the terminology and rhetoric associated with investment decision-making there is little in the Departments regulations or explanations for them which reflects that it has drawn on a serious and deep understanding of the actual practice of making such decisions; or if it has such an understanding it has not managed to convey it. Also despite the Department's expression of particular concern about the harm – actual or potential – to plan members caused by fiduciaries who make investments which might be identified with the ESG or rubrics there is little to nothing in the regulations or the Department's explanation for them that it has any serious and deep understanding of the actual practice of making investments in such terms and the extensive literature exploring the financial implications of doing so. Other submissions effectively flesh out those points in strongly questioning the Department's beliefs about how investing in that way might bear upon financial outcomes and the need for any prescription for the Department in light of them so there is no need to reprise them here.[2] We note, though, that although we share much of such critiques of the Department's proposed regulations which presuppose that a fiduciary's focus should be limited to matters relating to financial risk and reward, as will be clear from the text below, we do not share that presupposition.

With reference to the latter two points, we offer as examples, the following:

An abiding concern which appears to motivate the DOL's perceived need to formulate regulations of the sort under consideration now is that taking account of "ESG" considerations in investment decisions leads to risks that, other factors being equal, are returns greater and/or risks higher as companied to not doing so. However, there is an extensive research literature which has canvassed what the comparative outcomes have been. Research on that subject might not necessarily be viewed by some as dispositive and there are a variety of issues with the assumptions and methodologies employed in pursuit of the studies. Nonetheless, a considerable portion of that literature points to, among other things, returns for investments which take into account ESG-related considerations being no lower and perhaps being higher than does which do not.[3] There is no indication that the DOL has canvassed that very important literature to determine how it bears on the agency's analysis, conclusions, and proposed regulations. It needs to before reaching any conclusion with respect to the proposed regulations or variants thereof.

First, at root, the Department's ostensible concern is with fiduciaries who in their investment decision-making take account of what it terms "environmental, social, corporate governance, or other similarly oriented considerations". Although the Department refers to a term which has been widely used – "environmental, social, corporate governance" – and suggestive for the purposes of its regulation it offers specific prescription for it. Indeed, the Department goes further in according greater though ill-defined sweep to the application of that regulation by extending it to "other similarly oriented considerations."

Second, keeping with the Department's ostensible concern about a fiduciary focusing on "only pecuniary factors" deems ESG (and certain other) ones as pecuniary only if it is deemed in a certain way to be "a material economic consideration". Before turning to what might be so deemed we note that insofar as ESG (and certain other) factors are deemed not to be material economic considerations, use of them is permissible because employing them has no material bearing on outcomes of the investment in economic terms. Presumably, insofar as they are impermissible if the considerations bear materially in an adverse way on the outcomes of the investment in economic terms. There are several problems with this approach.

One difficulty is it that would appear that the Department has in its regulations and guidance not provided the criteria for what should be deemed to be "generally accepted investment theories," let alone identified with any specificity what investment theories have qualified or do qualify based on those criteria; and certainly any insight as to how any such theories might employed to in any way make the materiality assessment the Department requires.[4]

In this connection it is striking that there appears to have been no mention of Modern Portfolio Theory (MPT) – or for that matter anything which might be identified with an "investment theory" – in the official legislative history of ERISA (which was enacted 22 years after the publication of what has been viewed as a path-breaking paper identified with MPT written by Harry Markowitz).[5] Moreover, as far as we can determine, the Department may have made its first allusion to MPT only in 1996, twenty-two years after the enactment of ERISA in connection with investment advice in the context of defined contribution plans.[6] Moreover, it would appear that while Modern Portfolio Theory and other formulations cast in terms have investment theory has been embraced by many at the rhetorical level for a variety of reasons seems not to be used by practitioners in any literal sense. Indeed, there are serious questions about the relevance of "mainstream" investment theory more generally to investment practice.[7]

Another problem is that the Securities and Exchange Commission has exercised its authority to regulate disclosures by companies about their conduct (and the outcomes related to it) insofar as they are financially material – ostensibly from the standpoint of investors – to decisions to the purchase and sale of securities issued by those companies. Obviously such disclosures are very important to decision-making by fiduciaries. Nonetheless, the Department makes no mention let alone explains the connection between materiality so determined to materiality as it might be understood within the context of the Department's proposed regulations. We take up this point again below.

Moreover, the Department fails to provide any guidance, let alone criteria that a fiduciary must use to make the mandated comparisons. For example, the Department does not specify any time period with respect to which any required comparison should be made and why. Clearly, as a general matter, the differences might very well vary greatly with the time period chosen, so there are important questions as to it chosen which the Department does not address. Moreover, as a specific matter, among ESG considerations are ones many whose importance may play out fully over extended periods of time – whether the deleterious effects of climate change or otherwise – and in turn their impact on the financial rewards and (realized) risks of firms whose trajectories hinge on those considerations might not be strongly evident for some years. We note in this connection that discourse with respect to ESG and related notions is frequently bound up with how investments play out over the "long term"; commitments like those made by the Business Roundtable signatories emphasize a focus on long-term outcomes for shareholders in their companies; and retirement plans have long time horizons, potentially for individuals as much as 80 years or perhaps even more if a normal working lifetime and life after retirement are included and potentially indeterminate for defined benefit plans. So the Department needs to speak – but has not – to the length of the time frame – to understand such long term effects and impacts and how that bears on any special prescription it might seek to mandate for ESG-related investments.

Finally, although the Department mandates an assessment of financial returns and risks it does not specify which kinds of rewards and risks should form the basis for it. Clearly, there are a variety of measures for both with respect to which choices which must be made and justified. The Department does not address them. Moreover, neither in ERISA Section 404(a)(1) nor in the Act generally, does ERISA appear to offer a prescription with respect to financial returns as such. As discussed below, insofar as ERISA was almost exclusively focused on defined benefit plans then, understandably, its concern was with the prospects for the investment choices being made yielding a pattern of returns and accumulations thereof which would enable withdrawals to keep promises to make specific, regular (typically monthly) payments to qualified beneficiaries and other beneficiaries.

With respect to risk, the conventional approach has been to identify it with the standard deviation of returns (most likely total returns). ERISA Section 404(a)(1)(b) explicitly addresses the matter of risks, requiring that 'a fiduciary shall discharge his duties…. by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly imprudent to do so." Several aspects of that formulation stand out. In other words, the focus is specifically on downside risk ("risk of large losses"). Standard deviation is not a measure of such risk. The Department needs to address – which it does not – what is the proper measure of such risk, whether value-at-risk or something else, at minimum as it relates to the subject matter of the proposed regulation (though it would appear to need attending to in other contexts as well).

Moreover, although the pattern of anticipated financial returns or other attributes of would-be investments bear upon characterizations of risk, for the investment decision-maker judgments about how much of such risk in that aspect should be run depends on who is taking the risk. That is, such judgments involve not only the anticipated patterns (and the warrant for such anticipation) but also the consequences for those who bear the risk of one or another pattern being realized.

For example, for defined benefit plans, current retirees bear the risk of promised payments being made on an ongoing basis; current working plan members bear the risk not only of promised payments not being made at the commencement of their retirement but also, among other things, any shortfall in returns resulting in pressure to accept lower current wages to make greater contributions to provide sufficient assurance in that regard; shareholders bear the risk of not just profit being cut to make such contributions but perhaps the financial state of the plan reducing the market value of their shares and at the extreme threatening the financial viability of the company. Note that among the foregoing considerations are "non-financial" insofar as the Department seems to view as "financial" only those which directly pertain to the payment of benefits.

For defined contribution plans in a number of respects, the understanding of risk needs to be rather different since it is concerned with how plan members as individuals might bear it. That understanding is taken up below in connection with matters of return, especially as they involve individual account plans which afford members choices among a set of prescribed investments with different historical patterns of returns.

With regard to at least defined benefits it would appear, central to the Department's proposed regulations reliance on a "tie-breaker" test for assessing the appropriateness of investments which take into account "non-financial" considerations. The Department concedes that the "break the tie" notion is not tenable, that is "true ties rarely, if ever occur". That is, the Department envisions that any and all such investments must be assessed through an exercise which determines whether it provides no less returns (with the same risk) or no more risk (with the same returns) than any other among the universe of investments which do not and are suitable for comparison. For a number of reasons such a test is highly problematic and perhaps even meaningfulness. Certainly, there will likely be few circumstances under which any two investments will be otherwise identical (but for ESG considerations) and, in turn, subject to any "tie breaker" test. If so, such a test is largely meaningless or the test must be one with respect to investments which are sufficiently similar. In all events, the Department fails to offer any criteria by which determine which, if any, other investment (which does not take into account non-financial considerations) qualifies for the comparison.

Moreover, beyond the matter of which pairs of investments might qualify for comparison aside, there are a variety of problems with the Department's prescription for the tie-breaker exercise.

First, the Department does not specify any time period with respect to which any required comparison should be made and why. Clearly, as a general matter, the differences might very well vary greatly with the time period chosen, so there are important questions as to it chosen which the Department does not address. Moreover, as a specific matter, among ESG considerations are ones many whose importance may play out fully over extended periods of time – whether the deleterious effects of climate change or otherwise – and in turn their impact on the financial rewards and (realized) risks of firms whose trajectories hinge on those considerations might not be strongly evident for some years. (Note that discourse with respect to ESG, sustainability, and related notions is frequently bound up with how investments play out over the "long term"; commitments like those made by the Business Roundtable signatories emphasize a focus on long-term outcomes for shareholders in their companies; and retirement plans have long time horizons, potentially for individuals as much as 80 years or perhaps even more if a normal working lifetime and life after retirement are included and potentially indeterminate for defined benefit plans. So the Department needs to speak – but has not – to the length of the time frame – to understand such long term effects and impacts and how that bears on any special prescription it might seek to mandate for ESG-related investments.

Second, although the Department mandates an assessment of financial returns and risks it does not specify which kinds of rewards and risks should form the basis for it. Clearly, there are a variety of measures for both with respect to which choices which must be made and justified. The

Department does not address them. Moreover, neither in ERISA Section 404 nor in the Act generally, does ERISA offer a prescription with respect to financial returns as such. Insofar as ERISA was almost exclusively focused on defined benefit plans so, understandably, its concern was with the prospects for the investment choices being made yielding a pattern of returns and accumulations thereof which would enable withdrawals to keep promises to make specific, regular (typically monthly) payments to qualified beneficiaries and other beneficiaries.

With respect to risk, the conventional approach has been to identify it with the standard deviation of returns (most likely total returns). ERISA Section 404(a)(1)(C) explicitly addresses the matter of risks, requiring that 'a fiduciary shall discharge his duties…. by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly imprudent to do so." Several aspects of that formulation stand out. The focus is specifically on downside risk ("risk of large losses"). Standard deviation is not a measure of such risk. The Department needs to address – which it does not – what is the proper measure of such risk, whether value-at-risk or something else, at minimum as it relates to the subject matter of the proposed regulation (though it would appear to attend to it in other contexts as well).

Moreover, although the pattern of anticipated financial returns or other attributes of would-be investments bear upon characterizations of risk, for the investment decision-maker judgments about how much of such risk in that aspect should be run depends on who is taking the risk. That is, such judgments involve not only the anticipated patterns (and the warrant for such anticipation) but also the consequences for those who bear the risk of one or another pattern being realized.

For example, for defined benefit plans, current retirees bear the risk of promised payments being made on an ongoing basis; current working plan members bear the risk not only of promised payments not being made at the commencement of their retirement but also, among other things, any shortfall in returns resulting in pressure to accept lower current wages to make greater contributions to provide sufficient assurance in that regard; shareholders bear the risk of not just profit being cut to make such contributions but perhaps the financial state of the plan reducing the market value of their shares and at the extreme threatening the financial viability of the company. Note that among the foregoing considerations are "non-financial" insofar as the Department seems to view as "financial" only those which directly pertain to the payment of benefits.

For defined contribution plans in a number of respects, the understanding of risk needs to be rather different since it is concerned with how plan members as individuals might bear it. That understanding is taken up below in connection with matters of return, especially as they involve individual account plans which afford members choices among a set of prescribed investments with different historical patterns of returns.

Further, whatever the measure of financial return and risk, the prescribed comparison must be made with respect to a time period. The Department does not specify the time period to be used and the basis for choosing it. In all events, depending upon the time period, the differences in the returns and/or risks will vary, perhaps widely. The Department does not address this important issue. As suggested below, in the ESG, sustainability, etc. context and with respect to commitments like those made by Business Roundtable, the notion of assessing enterprise and investment performance over the "long term" is quite important. However, the Department fails to address the bearing of the importance of the "long term" on the relevant period for making the comparison it prescribes.

Individual Account Plans

Paragraph (c)(3) speaks to individual account plans. First, it makes clear that the requirements of paragraphs (b)(1) and (b)(2) apply to "a fiduciary's selection of an investment fund as a designated investment alternative in an individual account plan". Second, although paragraph (c)(1) applies as well the Department sets requires which it states apply the principles thereof. That is, although the Department permits inclusion in "investment platforms for defined contribution individual account plans" of "one or more environmental, social, corporate governance, or similarly oriented assessments or judgments in their investment mandates, or that include these parameters in the fund name," subject to certain requirements. One is that the fiduciary must use "only objective risk-return criteria.…in selecting and monitoring [such] investment alternatives (paragraph (c)(3)(i))) and another that the fiduciary must document how it has done so. paragraph (c)(3)(ii) A third bars adding any of the noted ESG-type alternatives "as, or as a component of, a qualified default investment alternative described in 29 CFR 2550.404c-5." Paragraph(c)(3)(iii)

Before turning to particular concerns with these provision, there are important more general ones with respect to them.

As implied above, whatever the merits of the Department's application of ERISA's section 404(a) fiduciary standard to the issues at hand with respect to defined benefit plans, it appears to proceed on the premise that such application would be the same with respect to defined contribution plans. There are several reasons for that being incorrect. First, the legislative history of ERISA makes clear that virtually the entire focus of efforts to address the problems to which it was a response was on defined benefit plans. Second, the particular wording of section 404(a) clearly reflects legislator's concerns about defined benefit plans. Third, there was minimal attention in the legislative history to what it termed "individual account plans" – among them defined contribution plans. Insofar as there was any attention to such plans with respect to fiduciary duty it appeared very late in the legislative process. That attention did not take the form of an articulation of fiduciary standard as it related to individual account plans as such; rather, it focused only on inclusion of an *exception* to fiduciary liability for what might otherwise be thought to be a breach of certain of the fiduciary's duties.

Inclusion of the exception was the result of concern with a special set of circumstances: certain fiduciaries viewed the plans they administered as offering a menu of investments from which plan members might choose as enabling them to "exercise[e] control over the assets in the[ir] account" (ERISA section 404(c)(1)(A)), the word "control" being associated with the ability of member, by virtue his or her choices, being able to sufficiently determine the anticipated pattern of risks and returns in a way suited to their own needs. In the legislative history that concern was articulated briefly and cryptically in the joint-committee report on the final draft of the legislation and with Congress through the Act delegating to the Department the responsibility to flesh it out the notion of control consistent with statutory language (and legislative intent).

As a result, the Department has through regulation and guidance devised a complicated set of criteria with respect to that exception. However, the Department has never *affirmative*ly addressed how fiduciary duty in the individual account context should be understood. Were it do so the Department would need to consider differences between defined benefit and individual account plans as they bear on such an understanding. In that regard, two features sharply distinguish defined benefit from defined contribution plans.

First, assessment of a fiduciary's investment decisions with respect to defined benefit plans is anchored in achievement of keeping plan promises, that is, ensuring the timely and full payment of - typically monthly, sums promised to plan member upon their retirement. By contrast, there is no such anchor with respect to individual account plans. (For certain plans, members may have an indirect role in the choice of the fiduciaries who make those decisions but that has no immediate bearing on the matter of the investment choices they might make.)

Second, by definition, members of defined benefit plans have no choice with respect to particular decisions about how investments of the assets in the plans are to be made in order to keep the promises to make pension payments. By contrast, it would appear that the vast majority of defined contribution plans allow plan members to select from an array of plan-offered choices for investments. By definition then, at least on their face, those choices are acts by individual plan members themselves, by definition, not acts of others – fiduciaries – who ostensibly would be making decisions on their behalf. This point is effectively recognized by the noted section 404(c) which arguably but by viewed as addressing the extreme case of members exercising “control” within the meaning of that provision.

In other words, as a formal and arguably as a practical matter plan members have and make choices as they might, in light of the menu of investments afforded to them. The availability of ESG-related choices aside, members have the opportunity to make those choices for any reason, not only of the reported financial characteristics of the investments but also any other attributes which plan members deem worthy of taking into account. This is true regardless of whether the funds are denominated as ESG or ESG-related or otherwise. Such other attributes might be ones associated with what are referred to as ESG considerations as they relate to particular companies whose issued financial securities are in the array of those defined by any particular investment choice. Certainly, in the absence of any such array being fashioned intentionally and specifically in light of ESG or ESG-related considerations, the ability of members to make choices in light of them might be very sharply constrained. Nonetheless they are free to do so even if in their judgment their selection might result in having chosen an investment with lower returns or higher risks than might be available to them, that is, it is not to their pecuniary advantage. (Of course, here as in any other aspects of investment choices proffered to plan members, they must be provided with data necessary to a sufficiently informed decision, i.e., understand whatever the tradeoffs, if any, there might between their taking account of those considerations and pecuniary considerations.) So the question is given that limited opportunity for choices of that sort why plan members should be entitled to a greater one.

Warrant for have members being so entitled is highlight by the Department’s focus in paragraph (c)(3) on “investment platforms for defined contribution individual account plans, including platforms with bundled administrative and investment services, that allow plan participants and beneficiaries to choose from a broad range of investment alternatives as defined in 29 CFR 2550.404c-1(b)(3),” The reference is clearly to those circumstances under which fiduciaries would be free from liability for a wide range of their decisions because it has been determined that under section 404(c) that plan members have “control” over their investments. That is, the notion is that plan members have been accorded significant freedom of choice in how and why they their investments. Nonetheless, at the same time the Department seeks to limit that choice in an important way,

This point is reinforced in light of experience with Individual Retirement Accounts, a matter to which the Department does not speak. Workers are free to roll over assets in their defined contribution plan accounts to Individual Retirement Accounts at retirement and at the time of leaving their employment and are often allowed to do so and at other times even during their employment (though they may be subject to penalties).[8] The extent of take up of those roll-over opportunities is reflected in the fact that a very large fraction of aggregate Individual Retirement Account assets are the result of such roll overs (rather than annual cash contributions to IRAs permitted by law). Owners of IRAs would appear to have almost unlimited play in making decisions about investing their contributions (or roll-over assets) based on whatever reasons, beliefs, feelings, etc. might motivate them. We are unaware of any limits in this regard as they pertain to “ESG”-related or similar attributes or characteristics of the investments so that such owners are essentially free to make investments which, by virtue of those attributes or characteristics, even though they might yield returns (at the same level of risk) or have higher risk (at the same level of return) than putatively comparable ones. Of course, here too, insofar as IRA account owners might make decisions based on “ESG”-related or other attributes or characteristics based on information and advice about the characteristics – ESG-related or otherwise – that information and advice should be provided in accordance with standards of completeness, truthfulness, etc. and the nature of the relationship of the individual with that provider.

The foregoing necessarily raises, but the Department does not address, the import of such extensive freedom of choice for IRA account holders and the close link (by way of roll overs) of a large portion IRA account assets to defined contribution plans for its decision for largely foreclose such choice member of defined contribution plans. It might be argued that accounts established in connection with employer-associated defined contribution plans are different from individually-based IRAs in that ERISA mandate individuals – denominated fiduciaries – being interposed between plan member account holders and the investments which with respect to which they might make choices. However, noted, as the vast majority of plans provide for members having considerable freedom to make choices among investments and by virtue of the provisions of 404(c) those who might otherwise be liable as fiduciaries in connection members’ decisions have no liability in the face of financial harm when those decisions go awry.

Regardless of the details of paragraph (c)(3), the preceding general comments relating to the Department’s proposed regulations defined contribution individual account plans cast serious doubt on the appropriateness of those regulations because they are grounded on the above-described limitation of fiduciary decision-making to pecuniary aspects of the investments being assessed. However, even if such a limitation were accepted in principle, the Department’s prescription in paragraph (c)(3)(i) fails for the same kind of reasons it fails with respect to defined contribution plans. In the abstract, there might be warrant for the documentation requirements of paragraph (c)(3)(ii). However, in practice, what documentation might be required/pass muster must be cabined in to avert undue and burdensome demands on fiduciaries’ time and resources. Unfortunately, the less than coherent and well-grounded requirements of paragraph (c)(3)(i) afford no effective means for tailoring what documents might be required to any regulatory need. Indeed, recent, arguably unusual and wide ranging (and highly burdensome) requests by the Department for documents from plans relating to their ESG investments and policies hardly affords confidence in this regard.[9] Moreover, one might well think that before issuing proposed regulations of the sort under consideration the Department might have first sought to understand the issues relating to such investment in policies in part through requests of reasonable scope. In all events, in the absence of a strong rationale, the nature and reach of any documentation requirement for ESG-related investments should be no different from any other class or type of investments.[10]

<u>The regulations as they relate to both defined contribution and defined benefit plans</u>

A core premise of the Department’s proposed regulations is that, in the first instance, investment decisions which take account of “non-pecuniary”/financial considerations are problematic because they raise concerns that doing so will yield less advantageous outcomes in financial terms. More specifically, those concerns relate to the enterprises which issue financial securities which might be among the objects of investment. So the ultimate issue is with such enterprises at least insofar as they take "non-financial" considerations into account in their business decisions; namely that their doing so might yield lower profits (or some other measure of financial reward) – presumably over some relevant period of time – than they might otherwise if they had not (controlling for some measure of the risk of not achieving their sought-for outcomes.)

If so, it would appear, then, that Department's proposed regulation could bar investments in a variety of companies. For example, so-called benefit corporations have legal sanction in 35 U.S. states and the District of Columbia. Their goals as reflected in their charters include not only the achievement of profit but also some "positive impact on society, workers, the community and the environment" and the "best interests" of such corporations include those outcomes.[11] As such, while such commitment will not necessarily lead to lower profitability or higher risks for ostensibly comparable companies – indeed, it might be the reverse – any such voluntary "sacrifice" of profit (or perhaps to increased risk) would appear to be rendered unacceptable by the proposed regulation.[12]

Potentially more broadly, in August 2019, the CEOs of 181 major U.S. corporate members of the Business Roundtable were signatories to a statement asserting that they "share a fundamental commitment to all of our stakeholders," which included not only the achievement of "long term value" on behalf of shareholders but also "value: for employees, suppliers, and the communities in which they work.[13] Although the statement does not specifically reference "ESG"-related considerations it is apposite with commitments and decisions cast in those or related terms, e.g., considerations of "sustainability," to attend to them. There are interesting and important questions about the precise meaning of the commitment of those signatories (and the companies they lead) its binding character, and the seriousness with which it was made. Nonetheless there is the distinctive possibility that the commitment might well entail trade-offs between shareholder and other stakeholders' interests. The reference in the statement with respect to the achievement of "long term value" is at least suggestive in that regard. That is, at minimum, the commitment envisions the sacrifice of the former's interests to those of the latter for some period of time on the premise that interests of shareholders might be advanced on some more extended, though indeterminate time period. (Of course, those shareholders include members of various kinds of retirement plans (as beneficial owners). Of necessity, then, the same problem about a bar to investment posed with respect to B-corporations is raised with respect to such companies. At minimum, then, the Department needs to study the current and potential impact of these and many similar or related corporate commitments in order to assess the wisdom and efficacy of its proposed limitations and exclusions on investment of retirement plan assets.

Such inquiry and assessment is important as well because there is evidence to suggest that companies' conduct, whether described in terms of "ESG, "sustainability," or otherwise or taking into account the interests of "stakeholders" other than shareholders looms larger for workers than in the past, perhaps especially so for younger workers, for example reflected in a greater unwillingness to work for companies whose conduct is problematic or make financial investments in such companies. This would suggest that the Department's proposed regulation might ill-serve many current workers who participate in retirement plans, perhaps even represent an obstacle to their participation, and increasingly so over time.

Moreover, issues raised by the Department's proposed regulations with respect to "ESG"-related considerations ostensibly in application of ERISA, are not unlike those posed for the SEC is considering with regard questions raised by securities law in that both presuppose a perhaps understandable but faulty view of the actors – the human beings –whose interests are ultimately to be served.by the regulations.

With regard it its task, the SEC is concerned with what about a company and its conduct "investors" deem to be "financially material" because it bears on their decisions to buy and sell securities. However, while in speaking to that concern the SEC properly assumes that the human beings who are investors view their decisions to a greater or lesser degree on the basis of the financial risks and rewards of holding and/or trading those securities the agency can and should reflect in its regulations that in reality those same individuals also make their decisions to a greater or less degree on the basis of considerations arguably unrelated to those risk and reward, for example, on the appropriateness or wrongfulness of the conduct of the companies who have issued those securities. Numerous surveys suggest that such individuals assert that they do or would make their investment decisions on such a basis. Moreover, importantly, it is clear that many have in fact done so as reflected in decisions which they have made – which are not subject to the kinds of strictures which inform the stance held by the Department in the retirement plan context – to choose investment vehicles which specifically exclude the securities of companies whose conduct is thought by them to be unacceptable as such.

The Department has taken a roughly analogous approach to its task with regard to retirement plan members' (well warranted) interest in retirement benefits understood in a pecuniary sense. That is, the Department sees those members as having those pecuniary benefits as their sole concern. The reality is that the plan members and beneficiaries who are the objects of the Department's concern are no less human beings than the "investors" who are the focus of the SEC' attention, human beings who see the investment choices they make – or those made on their behalf – in terms of more or other than matters of financial risk and reward. Nonetheless, the Department fails to take cognizance of that fact. That is troubling in itself. It is even more given the noted freedom to look beyond pecuniary outcomes enjoyed by others in the context of government-incentivized vehicles for financial security in retirement– IRA holders – and outside of the context in the form of voluntary saving for retirement)and other purposes).

In this connection, we note that there is some analogy here with cases in which government regulation bears on the ability of people to honor/"live out" their commitments of an important normative or related nature. The most dramatic may be ones which implicate constitutional law especially as it pertains to religion provisions of the First Amendment. For example, recent litigation required the Supreme Court to assess the constitutionality of regulations which it was claimed forced certain individuals to engage in conduct which violated the tenets of the religious faith they had embraced. Our concern here is not with the merits of the Court's decision with respect to those particular claims but to suggest that the concerns about such commitments in ERISA context resonate or are in some measure apposite with those which inform the noted cases. In this regard we note that the larger movement within which the current one cast in terms of ESG-related or similar considerations has roots in the deep concern of faith-based investors about choices of investments which were at variance with their religious commitments. Whatever its conclusion in this regard, the Department needs to grapple in a serious-minded way with such concerns before finalizing any regulation.

In light of the foregoing, I urge you to allow the existing guidance to remain in effect and withdraw the proposed role; or failing that, at minimum, extend the time for submission of comments for at least an additional sixty days or such time as is required by the holding public hearings on and by the engaging in further research on the issues raised by this and others' submissions, whichever is later.

Sincerely,

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[1] For approximately 14 years I served as the Director of the Pensions and Capital Stewardship Project (PCSP), part of the Labor and Worklife Program (LWP) at Harvard Law School and subsequently through the present as a Fellow at the LWP. I also carry out related activity outside of the LWP for or with respect to various actors in the field defined by the work there. As Director I organized and ran many annual conferences for pension fund trustees joined by investment practitioners, labor leaders, political officials, academics, and others, which included exploration of the issues of and related to fiduciary duty; for several years organized and convened an annual education program for public sector pension trustees which addressed matters of fiduciary duty; led classes on the subject every year as part of the Harvard Trade Union Program (participants of which included private and public sector pension fund trustees); gave many presentations to diverse audiences on the topic; and researched and wrote papers on fiduciary duty and related issues. Some most pertinent here include "Paradigm lost: employment-based defined benefit plans and the current understanding of fiduciary duty," Chapter 9 in *Cambridge Handbook of Institutional Investment and Fiduciary Duty*, Edited by James P. Hawley, Andreas G. F. Hoepner, Keith L. Johnson, Joakim Sandberg, and Edward J. Waitzer, 2014 (with a special focus on defined benefit plans) and ""Whose Power? Whose and Which Duties? Pension Fund Investments and Fiduciary Duties in the United States and India," Pensions and Capital Stewardship Project, Labor and Worklife Program, 2015. https://lwp.law.harvard.edu/publications/whose-power-whose-and-which-duties-pension-fund-investments-and-fiduciary-duties (with a focus on defined contribution plans.) I am currently engaged in a work-in-progress which traces the origins and assesses the meaning and import of the fiduciary duty provisions of ERISA 404(c) relating to individual account plans.

[2] See for example, the submission by David B. Keto, Managing Principal, July 17, 2020.

[3] See, for example, Gunnar Friede, Timo Busch, and Alexander Bassen, "ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies," Journal of Sustainable Finance & Investment 5, no. 4 (2015): 210-33, https://www.tandfonline.com/doi/pdf/10.1080/20430795.2015.1118917

[4] It is interesting and perhaps revealing in this connection, that in response to the 2010 proposed rule on Investment Advice—Participants and Beneficiaries issued by the Department of Labor on February 26, 2010, which was to amend guidance issued in 2009, there numerous comments expressing strong opposition to the Department having any rule in regulating what are termed "general accepted investment theories."

[5] Clearly s. 404(a)(1)(C) refers to a presumptive need for diversification but insofar as references to it were made in the Legislative history they appear not to have risen a level above of citation of the popular saying about putting too many eggs in one basket or effective variants thereof; that is, there was no indication which gave a more specific understanding of the import of diversity on the basis of the kind of assumptions Markowitz made.

[6] It appears that it was only in connection with an interpretive regulation concerned with defined contribution plans that the Department first mentioned MPT. Moreover, there actually was no reference to MPT in that regulation. Rather in the accompanying narrative stating the Department's reasoning behind the regulation, the DOL remarks upon MPT in the context with the regulation's requirement for reliance on asset allocation models "based on generally accepted investments theories that take into account the historic returns of different asset classes (e.g., equities, bonds, or cash) over define periods of time". That is, as the Department explained, it had "included this requirement to assure that, for purposes of the safe harbors, any models or materials presented to participants or beneficiaries will be consistent with widely accepted principles of modern portfolio theory, recognizing the relationship between risk and return, the historic returns of different asset classes, and the importance of diversification." See Proposed § 2509.96–1(c)(3)) "Interpretive Bulletin 96–1, Participant Investment Education; Final Rule. Federal Register, 61(113), pp. 29586-29590, 29589, June 11, 1996. www.dol.gov/ebsa/regs/fedreg/final/96_14093.pdf

[7] See, for example, "Stronger Investment Theory, Embracing Complexity," Willis Towers Watson, 2016. https://www.thinkingaheadinstitute.org/en/Library/Public/Research-and-Ideas/2016/07/Stronger-investment-theory See also "How Professionals Invest," Chapter 3 in *New Principles of Equity Investment,* by Les Coleman, Emerald Press, 2019, pp. 57-77.

[8] The issue with respect to defined benefit plan is another matter, but certainly in the event of a DB plan termination, plan members can roll their lump sum distribution into an IRA. "Can a defined benefit plan be rolled over into an IRA?" by Paul Sundin, Emparion. https://www.emparion.com/can-a-defined-benefit-plan-be-rolled-over-into-an-ira/

[9] "UPDATE: EBSA Probing ESG Holdings, Policies," by Nevin E. Adams, American Society of Pension Professionals & Actuaries, June 15, 2020. https://www.asppa.org/news/update-ebsa-probing-esg-holdings-policie

[10] In this connection, the recent EBSA information letter giving the go-ahead to including "private equity investments as a component of a professionally managed asset allocation fund offered as an investment option for participants in defined contribution plans" is striking. "U.S. Department of Labor Issues Information Letter on Private Equity Investments," U.S. Department of Labor, June 3, 2020. HTTPS://WWW.DOL.GOV/NEWSROOM/RELEASES/EBSA/EBSA20200603-0 Private equity investments pose a series of challenging issues, among them ones with regard to their nature, complexity, cost, and transparency (and related matters of accountability). Many plan members face serious enough problems in understanding the publicly traded equities in the investment vehicles plans proffer to them; those problems are multiplied many-fold with respect to private equity stakes. Despite that the letter and the Department's action with regard to inclusion of such investments among their plan choices seems not to reflect the same urgent concern and demands as have been elicited by ESG-related investments.

[11] "Benefit corporation," Wikipedia. https://en.wikipedia.org/wiki/Benefit_corporation

[12] It has been suggested that "across 60 nations, there are 2,655 B Corporations, certified by the non-profit B Lab. There are 5,400 similar *benefit corporations* embracing a public purpose through incorporation statutes across 34 US states, including firms like Kickstarter, Patagonia, and King Arthur Flour." "The End of the Corporation," by Marjorie Kelly, Resilience, March 2, 2020. https://www.resilience.org/stories/2020-03-02/the-end-of-the-corporation/ "Existing Certified B Corps have gone public, like Laureate and Silver Chef. Publicly-traded companies have also achieved B Corp Certification, such as Natura. Many other Certified B Corps are subsidiaries of publicly-traded companies, such as Ben & Jerry's and Sundial Brands (owned by Unilever) and New Chapter (owned by Proctor & Gamble)." "Are any B corps publicly traded?" B Corporation. https://bcorporation.net/faq-item/are-any-b-corps-publicly-traded

[13] "Statement on the Business Purpose of a Corporation," Business Roundtable, August 2019. https://opportunity.businessroundtable.org/wp-content/uploads/2020/06/BRT-Statement-on-the-Purpose-of-a-Corporation-with-Signatures.pdf