New America

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RE: RIN 1210-AB95

Attention: Financial Factors in Selecting Plan Investments

To Whom It May Concern:

We are writing in opposition to proposed rule RIN 1210-AB95. We believe the proposed rule is detrimental to the interests of both pension fiduciaries and beneficiaries. Below we present five main discussion points.

DISCUSSION

1. **The proposed rule disregards significant market-based and academic evidence for ESG investment and discourages fiduciaries from incorporating ESG criteria.** The proposed rule discounts market validation for weighing ESG factors by failing to recognize the enormous growth in ESG investing over the last decade and the increased demand from investment professionals and retail investors for standard setting, quantitative studies, and integration of ESG into financial models. It further ignores a vast body of empirical evidence validating the benefits of ESG investing, including quantitative and qualitative academic studies and surveys. Finally, by including barriers to considering ESG criteria, such as cost benefit analysis and burden of proof through comparative tests that are not applied to other strategies, the proposed rule discourages fiduciaries from participating in a market trend that has grown rapidly over decades and from applying new academic studies and evidence in their investment process. This effectively leaves pension fund fiduciaries behind other market participants and potentially damages the interests of plan beneficiaries.

   The DOL expresses concern over an increased emphasis in the marketplace on investments and investment strategies that further non-pecuniary objectives, with particular reference to the term environmental, social, and corporate governance (ESG) investing. However, responsible investment is an approach to investing **that explicitly acknowledges the relevance to the investor of ESG factors**. It recognises that the generation of long-term sustainable returns is dependent on stable, well-functioning and well governed social, environmental and economic systems. ESG factors take into account long-term risks and returns and are therefore aligned with the investment objectives of pension assets and the best interests of beneficiaries. In this context, investment decisions which include the

consideraton of ESG factors are in line with fiduciary responsibilities to plan participants, and the costs associated with ESG investments are reasonable and justifiable. The coronavirus pandemic provides vivid evidence of how a failure to adequately consider and address environmental, social, and governance factors can have a devastating impact on market performance.

The enormous growth in the marketplace of investments that focus on ESG[1] (non-pecuniary, according to the DOL), actually helps to validate the materiality of ESG and its relevance for the investment industry, both in the context of financial return as well as risk mitigation. While there may be limitations and challenges in applying ESG principles to investments,[2] [3] not aknowledging its importance and devising regualtory policies that may discourage rather than promote its application, adversely impacts the interests of plan beneficiaries. Numerous academic studies support ESG investments and demonstrate materiality of ESG factors in selecting investments. [4] [5] [6] [7] [8] [9]

A report published by the IFC in 2019 contained survey results indicating that 84% of over 230 Public Pension Funds and Sovereign Wealth Funds polled in 2017–18 "felt that responsible investing (ESG) is somewhat-to-very important to both their stakeholders and their organizations." Moreover, 80% of the same cohort of funds stated that "responsible investing is consistent with fiduciary duty," and over 90% felt that ESG is neutral-to-positive for risk-adjusted returns."[10]

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[1] US SIF Foundation, 2018, "Report on US Sustainable, Responsible and Impact Investing Trends 2018". https://www.ussif.org/files/Trends/Trends%202018%20executive%20summary%20FINAL.pdf.

[2] Susanna Rust , IPE magazine July/August 2020, 7 February 2020, "ESG, risk sharing and more in EU pensions expert group final report". https://www.ipe.com/news/esg-risk-sharing-and-more-in-eu-pensions-expert-group-final-report/10043653.article.

[3] Dr. Barbara Weber (B Capital Partners) and Britta Rendlen (WWF Switzerland), 2018. "Integrating ESG factors into financial models for infrastructure investments". http://awsassets.panda.org/downloads/wwf_guidance_note_infra_.pdf.

[4] Khan, Mozaffar N., George Serafeim, and Aaron Yoon. March 2015. "Corporate Sustainability: First Evidence on Materiality". Harvard Business School Working Paper, No. 15-073. https://dash.harvard.edu/bitstream/handle/1/14369106/15-073.pdf?sequence=1.

[5] N. C. Ashwin Kumara, Camille Smitha, Leïla Badisa, Nan Wanga, Paz Ambrosya and Rodrigo Tavaresb, Journal of Sustainable Finance & Investment, 2016, "ESG factors and risk-adjusted performance: a new quantitative model". https://www.unpri.org/Uploads/g/t/y/ESG-Factors-and-Risk-Adjusted-Performance.-A-New-Quantitative-Model.pdf.

[6] Deutsche Asset & Wealth Management Special Issue 11, "ESG & Corporate Financial Performance: Mapping the global landscape". https://www.unepfi.org/fileadmin/events/2018/sydney/ESG-and-Corporate-Financial-Performance.pdf

[7] Sakis Kotsantonis, Christopher Pinney and George Serafeim, Journal of Applied Corporate Finance, Vol 28, 2016, "ESG Integration in Investment Management: Myths and Realities". https://www.hbs.edu/faculty/Pages/item.aspx?num=51511.

[8] Andrey Choi, Journal of Applied Corporate Finance, Vol 28, Issue 2, July 2016, "Morgan Stanley Perspectives on Sustainable Investing: Acceleration and Integration". https://onlinelibrary.wiley.com/doi/abs/10.1111/jacf.12176.

[9] Peter Roselle, Applied Corporate Finance, Vol 28, Issue 2, 2016, "Sustainability and Shareholder Value", https://advisor.morganstanley.com/mark.c.callaway/documents/field/c/ca/callaway-mark-c/Roselle_ESG_Article_%28JACF%29_July_2016.pdf.

[10] IFC, Creating Impact: The Promise of Impact Investing, April 2019, page 65. https://www.ifc.org/wps/wcm/connect/publications_ext_content/ifc_external_publication_site/publications_listing_page/promise-of-impact-investing.

In parallel, we see a rising trend of global regulators incorporating ESG practices and disclosures in pension fund management.[11] [12] [13] [14] For example, the revised Institution for Occupational Retirement Provision Directive issued by the EU in 2016 required pension funds to take ESG factors into consideration when investing their funds. In the summer of 2019, the EU's quasi-regulatory agency for pensions, the European Insurance and Occupational Pensions Authority issued an opinion to country regulators on how ESG factors should be taken into account. This was in addition to EU Directives that already required IORPs to publicly disclose how they integrate and implement shareholder engagement in their investment strategy.[15] As of October 2019 the UK begun to require that Statements of Investment Principles for both DB and DC plans must address ESG considerations. Similar trends are seen in other leading economies.[16] [17] [18]

These regulatory trends confirm the materiality of ESG, and justify its application through common taxonomies, benchmarks and globally recognized standards (PRI, TCFD and others). Global collaborative efforts by institutional investors, academics, government agencies, multilaterals, foundations, non-profits and private market players to create uniform, standardized frameworks (for example, SASB[19] and TCFD in the US) provide further confirmation that the market perceives ESG as material[20] for investment decision making. The Securities Exchange Commission (SEC) in the US has recognized "the many useful standards such as GRI, SASB and TCFD, to name a few, that may help to shape its thinking" and that "thoughtful work has already been done in mapping out what investors consider to be material, decision-useful ESG information."[21]

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[11] Responsible Investors, July 17, 2020, "EU financial supervisors tell rulemakers to create social taxonomy, ESG benchmarks and data hub". https://www.responsible-investor.com/articles/eu-financial-supervisors-tell-rulemakers-to-create-social-taxonomy-esg-benchmarks-and-data-hub.

[12] Stefano Spinaci, European Parliamentary Research Service, January 2020, "Sustainable finance and disclosures: Bringing clarity to investors". https://www.europarl.europa.eu/RegData/etudes/BRIE/2019/635572/EPRS_BRI(2019)635572_EN.pdf.

[13] Francesco Guarascio, Reuters, November 4, 2019, "EU rules on responsible investments to kick in from 2021: document". https://www.reuters.com/article/us-eu-regulations-sustai nablefinance/eu-rules-on-responsible-investments-to-kick-in-from-2021-document-idUSKBN1XE1U3.

[14] Chris Wagstaff and Chris Anker, Columbia ThreadNeedle Investments, December 2019, "Why 2020 Will Be The Year Europe's Pension Schemes Engage With ESG". https://www.columbiathreadneedle.be/insights/2019/12/why-2020-will-be-the-year-europe's-pension-schemes-engage-with-esg.

[15] Groom Law Group, July 17, 2019, "European Pension Authority Issues Opinion on ESG Pension Investing". https://www.groom.com/resources/european-pension-authority-issues-opinion-on-esg-pension-investing/.

[16] For Australia: Laura Dew, Money/Managemnet, 15 July, 2020, "Australia taking 'meaningful steps' to integrating ESG in super". https://www.moneymanagement.com.au/news/superannuation/australia-taking-'meaningful-steps'-integrating-esg-super.

[17] For Japan: Masako Oshima, "ESG in Japan: World's Largest Pension Fund Leads Rapid Growth". https://radar.sustainability.com/issue-17/esg-in-japan-worlds-largest-pension-fund-leads-rapid-growth/; Ministry of Economy, Trade and Industry of Japan, 2017. "Guidance for Integrated Corporate Disclosure and Company-Investor Dialogues for Collaborative Value Creation" https://www.meti.go.jp/english/press/2017/0529_004.html.

[18] For Netherlands: Pension Federatie, "The Code of Dutch Pension Funds", 2018. https://www.pensioenfederatie.nl/website/engelse-website/publications-in-english/code-of-the-dutch-pension-funds; The Dutch Association of Company Pension Funds & Dutch Association of Industry Wide Pension Fudns, "The Dutch Pension System: an overview of the key aspects". https://mhpf.nl/wp-content/uploads/2018/03/TheDutchPensionSystem.pdf; De Nederlandsche Bank N.V., 2016, "Sustainable investment in the Dutch pension sector". https://www.dnb.nl/en/binaries/Sustainable%20investement%20in%20the%20Dutch%20pension%20sector_tcm47-346418.pdf

[19] SASB is committed to facilitating more effective disclosure of material sustainability information by issuers to investors. The SASB's due process is designed to produce standards for information that is: reasonably likely to be material; decision-useful for companies and their investors; and cost-effective for corporate issuers. See SASB Conceptual Framework, https://www.sasb.org/wp-content/uploads/2019/05/SASB-Conceptual-Framework.pdf.

[20] Jean Rogers George Serafeim, Harvard Business School Accounting & Management Unit Working Paper No. 20-056, 2019, „Pathways to Materiality: How Sustainability Issues Become Financially Material to Corporations and their Investors". https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3482546.

[21] Investor-as-Owner Subcommittee of the SEC Investor Advisory Committee, Recommendation Relating to ESG Disclosure (As of May 14, 2020). https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-of-the-investor-as-owner-subcommittee-on-esg-disclosure.pdf

In this regard, introducing regulatory text which not only limits the consideration of ESG in the investment decision-making process but that also actively discourages[22] its' application can only be detrimental to pension plan beneficiaries. We believe the DOL should adopt regulatory text which clarifies that ESG plays an important role in financial risk and return for investment portfolios and that its consideration is consistent with fiduciary duty.

2. **The proposed rule promotes short-termism and ignores the beneficial impacts of ESG on long-term portfolio value creation.** As a regulator and policy maker, the DOL has a duty of care in setting the tone for long-term investing and in preventing short-termism in financial markets. By discouraging pension funds from considering ESG in their portfolios, the proposed rule has the opposite effect on investors, with adverse consequences for the long-term interests of plan beneficiaries. Policy and regulatory text should be aligned with protecting beneficiaries' interests over the long-term.

   Too often, the pressures of short-termism – from quarterly earnings reports to investment vehicles valued daily or monthly, to management compensation incentive schemes – cause companies to neglect ESG issues, which, by their nature, tend to be more long-term oriented in the context of strategy and performance.[23] Numerous studies confirm that ESG promotes long-termism.[24] [25] [26]

   Short-termism, sometimes referred to as earnings management, consists of an excessive focus by corporate managers, asset (portfolio) managers, investors and analysts on short-term results, whether quarterly earnings or short-term portfolio returns, contrary to long-term fundamental analysis and value creation. Any regulatory text which promotes short-termism, even indirectly, can adversely impact the long-term risk adjusted return performance of pension assets and be detrimental to the best interests of plan participants.

   For reasons discussed in this document, the text proposed by the DOL would discourage pension funds from considering ESG factors in the course of investment selection. In particular, pension fiduciaries would have the extra burden of proving that selected investments are as good as any other investment.

   There is always an element of uncertainty in quantifying the future impact of ESG factors, even once asset-specific circumstances are known to the investor. And despite the fact that the same challenge may exist with respect to forecasting the impact of traditional financial factors or measures, the DOL's proposal discriminates against the consideration of ESG

[22] History of interpretative bulletins demonstrates the negative effect the 2008 version had on application of ESG considerations.
[23] KPMG Board Leadership Center, 2017, "ESG, strategy and the long view: A framework for board oversight". https://assets.kpmg/content/dam/kpmg/lu/pdf/lu-en-esg-strategy-framework-for-board-oversight.pdf.
[24] Andy Green and Andrew Schwartz, Center for American Progress, October 2, 2018, "Corporate Long-Termism, Transparency, and the Public Interest". https://www.americanprogress.org/issues/economy/reports/2018/10/02/458891/corporate-long-termism-transparency-public-interest/.
[25] Marc Jarsulic, Brendan V. Duke, and Michael Madowitz, October 2015, "Long-Termism or Lemons: The Role of Public Policy in Promoting Long-Term Investments". https://cdn.americanprogress.org/wp-content/uploads/2015/10/21060054/LongTermism-reportB.pdf.
[26] Lynne L. Dallas, Journal of Corporation Law, 2015, "Short-Termism, the Financial Crisis and Corporate Governance". https://www.researchgate.net/publication/228215337_Short-Termism_the_Financial_Crisis_and_Corporate_Governance.

factors *vis-à-vis* such other factors. As a result, pension fiduciaries may be discouraged from engaging in in ESG strategies due to concerns about the unique, undue burdens associated with safely documenting the positive impacts of ESG on financial return and risk mitigation. They may be worried about the risk that such reporting could be deemed *not relevant* and unreasonably expensive, a risk that does not exist with other portfolio strategies.

Regulators set the tone and send a signal to the market about the relevance and importance of investment trends and frameworks. In this regard, we believe the DOL should adopt language that clarifies fiduciary responsibility and requires a long-term, risk-adjusted approach to the management of pension assets so as to deliver sustainable returns to beneficiaries in an impartial manner and encourages asset owners to fully consider long-term factors (including ESG issues) in their decision-making and the decision-making of their agents.

The regulator also has an important role to play in increasing trust and confidence in the pension industry and encouraging pensioners to save more. Discouraging the application of ESG in pension funds at a time when market demand for ESG investments is expanding rapidly, undermines confidence and trust. Moreover, savers looking to invest in ESG related funds may be discouraged from increasing their contributions if such options are not made available to them.

3. **The proposed rule contradicts regulatory work undertaken by the SEC to form a common, uniform disclosure framework for ESG considerations.** Given trillions of dollars invested into ESG strategies, dozens of academic studies supporting the inclusion of ESG factors in investing decisions, and the interests of global regulators and government agencies to incorporate ESG data, it is clear that the use of ESG-related disclosures has become a mainstream investment practice. The SEC Investor Advisory Committee held three sessions on the topic of ESG disclosures in 2016, 2018 and 2019. The perspectives of a variety of market participants were reported and evaluated, including supporting documentation.[27] The SEC also held conversations with a number of investment advisors, asset managers, asset owners, US and foreign issuers, third party data providers, NGO's, and proponents of third-party disclosure frameworks. The overwhelming conclusion reached by the committee was that ESG disclosures are material to investors regardless of an issuer's business line, financial model, or geography. Yet, contrary to the SEC's position, the DOL proposed rule pushes back against ESG and limits the ability of pension fiduciaries to incorporate ESG data into investment decision-making and portfolio strategies.

   In May 2020, a recommendation issued by the **Investor-as-Owner Subcommittee** of the **SEC Investor Advisory Committee (the Subcommittee)** stated: "For close to 50 years, the SEC

[27] Petition for a rulemaking on environmental, social, and governance (ESG) disclosure authored by Osler Chair in Business Law Cynthia A. Williams, Osgoode Hall Law School, and Saul A. Fox Distinguished Professor of Business Law Jill E. Fisch, University of Pennsylvania Law School, and signed by investors and associated organizations representing more than $5 trillion in assets under management including the California Public Employees' Retirement System (CalPERS), New York State Comptroller Thomas P. DiNapoli, Illinois State Treasurer Michael W. Frerichs, Connecticut State Treasurer Denise L. Nappier, Oregon State Treasurer Tobias Read, and the U.N. Principles for Responsible Investment, October 1, 2018. https://www.sec.gov/rules/petitions/2018/petn4-730.pdf.

has periodically contemplated whether ESG disclosures are material and should be incorporated into its integrated disclosure regime for SEC registered Issuers. This recommendation asserts that the time has come for the SEC to address this issue. Addressing ESG disclosure now will (a) provide investors with the material, comparable, consistent information they need to make investment and voting decisions, (b) provide Issuers with a framework to disclose material, decision-useful, comparable and consistent information in respect of their own businesses, rather than the current situation where investors largely rely on third party ESG data providers, which may not always be reliable, consistent, or necessarily material, (c) level the playing field among all US Issuers regardless of market cap size or capital resources, (d) ensure the continued flow of capital to US Issuers, and (e) enable the SEC to take control of ESG disclosure for the US capital markets before other jurisdictions impose disclosure regimes on US Issuers and investors alike."[28]

In the text of the recommendation, the Sub-committee further asserted that:

- **Investors require reliable, material ESG information upon which to base investment and voting decisions.** Trillions of investment, savings and retirement dollars are invested globally in businesses where material ESG information is relevant to investment and voting decisions. Investment and voting based in part on **ESG disclosure is front and center in today's global investment ecosystem**.
- **Issuers should directly provide material information to the market relating to ESG Issues used by investors to make investment and voting decisions.** Ratings agencies and proxy advisory firms, both of which are heavily relied upon by investors in making their investment and voting decisions, as relevant, are basing their ratings and recommendations on primary information provided by the Issuers themselves in their public disclosure filings. Both investors and third-party data providers should have accurate, comparable, and material Issuer primary-source information upon which to base their analysis, and that there are consistent standards and oversight governing the disclosure of this data.
- **Requiring material ESG Disclosure will level the playing field between issuers,** helping smaller and mid-cap size companies to produce comparable information.
- **Ensure the flow of capital to the US Markets and to US Issuers of all sizes.** Many investors view material ESG factors as critical drivers of risks and returns in their investment making decisions, both in the short and long term. Requiring disclosure of this information directly by the Issuer will facilitate the flow of capital to US Issuers of all sizes from investors with or without ESG-related investment mandates.
- **The US should take the lead on material ESG disclosures.** The US capital markets are the largest and deepest in the world. Therefore, the SEC should take the lead on this issue by establishing a principles-based framework that will provide the Issuer-specific material, decision-useful, information that investors (both institutional and retail) require to make investment and voting decisions.

[28] Investor-as-Owner Subcommittee of the SEC Investor Advisory Committee, Recommendation Relating to ESG Disclosure (As of May 14, 2020). https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-of-the-investor-as-owner-subcommittee-on-esg-disclosure.pdf.

The ESG considerations raised by the SEC Sub-committee have important implications for pension fund fiduciaries and plan beneficiaries. Pension funds should take advantage of uniformly disclosed, material ESG information to achieve better diversification and efficiency. Their portfolios will benefit if US companies remain attractive to foreign investors that have an ESG lens. They will need to monitor portfolio company ESG disclosure standards, reporting and compliance with ESG requirements as part of their investment process. The proposed rule, however, will limit pension fund fiduciaries from taking advantage of the forthcoming SEC framework, potentially disadvantaging pension schemes and their beneficiaries compared to other market participants.

From a wider perspective, the proposed rule sends a signal to the marketplace - rather than support the SEC recommendation that the **US should take the lead on disclosure of material ESG information**, the DOL elects instead to move pension funds in a different direction. It will be confusing for pension fund fiduciaries to reconcile the contrary approaches to ESG of the DOL and the SEC.

We believe that any regulatory text proposed by the DOL related to ESG should be sensitive to the issues described in this section as well as the issues described elsewhere in this document.

4. **The proposed rule takes an unfounded and unreasonably narrow view of fiduciary duty, overlooking and misinterpreting key concepts of prudence and loyalty.** Based on current best practice and established academic studies supporting the positive impact of material ESG considerations on long-term portfolio value creation, NOT requiring ESG in the investment process should qualify as a breach of fiduciary duty, under existing ERISA text.[29]

   The DOL has construed that a fiduciary must act solely in the interest of, and for the exclusive purpose of providing financial benefits to, plan participants. Accordingly, a fiduciary may not subordinate the financial interests of beneficiaries to **unrelated objectives**. In the proposed rule, by increasing the burden of proof for incorporating ESG factors into investing and qualifying ESG as a secondary consideration when selecting investments, the DOL clearly implies that it considers ESG as an **unrelated objective**.

   This categorization of ESG as an unrelated objective is an absurd interpretation that contradicts market- and academic-based investment knowledge establishing ESG factors as an inherent part of the investment process. For example, research studies show that companies which score highly on material ESG factors in the investment process tend to outperform financially.[30] Further studies show that ESG consideration can lead to a consistent reduction in portfolio risk, a decrease in the cost of debt and lower capital constraints for portfolio companies.[31] In this regard, not including ESG factors when it has

[29] Robert G. Eccles and Svetlana Klimenko, The Investor Revolution, May – June 2019, https://hbr.org/2019/05/the-investor-revolution.
[30] Khan, Mozaffar N., George Serafeim and Aaron Yoon, Harvard Business School Working Paper, No. 15-073, March 2015, "Corporate Sustainability: First Evidence on Materiality". https://dash.harvard.edu/bitstream/handle/1/14369106/15-073.pdf?sequence=1.
[31] Kaiser, L., Journal of Asset Management, 2020, "ESG Integration: Value, Growth and Momentum". https://doi.org/10.1057/s41260-019-00148-y https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2993843.

been clearly shown to mitigate risk and improve long-term portfolio returns is against the best interests of plan participants.

Further, ERISA provides for the temporal application of fiduciary standards by requiring "care, skill, prudence, and diligence under **the circumstances then prevailing that a prudent man[32] acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims**." Current trends clearly demonstrate how a *prudent man* would act in relation to investments in like circumstances and with like aims not only in US market but globally.[33]

Ignoring or limiting ESG disregards this time-honored notion of "under the circumstances then prevailing", a well formulated and wise temporal lens envisaged many years ago. Standards of prudence evolve and fiduciary principles are dynamic concepts that should be adapted over time in response to advances in knowledge and changes in circumstances.[34] Today, with the unprecedented growth of institutional assets related to ESG, and the greater appreciation we have for the shortcomings of older investment theories in the face of financial crises, we need to recalibrate our thinking on the role of fiduciaries. "Trust investment law should reflect and accommodate current knowledge and concepts. It should avoid repeating the mistake of freezing its rules against future learning and development."[35]

The authors of ERISA recognized that financial markets are not static and that the standards of prudence should evolve together with market forces and prevailing knowledge. It is time to acknowledge that diversification is an important but not the only method for mitigating portfolio risks. Being blindsided by systemic risks that could be captured by ESG strategies, but that are rendered unavailable to long-term investors because of a fixed dogmatic approach to investing, is not in the best interests of pension plan beneficiaries.

Examining how fiduciary duty is interpreted by the courts may be instructive. Existing interpretations show that the ERISA text is sufficient to cover all essential elements of fiduciary duty to ensure protection of beneficiaries' interests and allows fiduciaries to focus on the thorough process of investing rather than just financial results. In other words, including ESG as part of a thorough investment process is consistent with the ERISA definition of fiduciary duty.

In *Donovan v. Cunningham*[36] the court argued that the first obligation of a fiduciary is a *duty of loyalty* pursuant to which "all decisions regarding an ERISA plan must be made with an **eye single to the interests of the participants and beneficiaries**." The second obligation imposed under ERISA, the ***prudent man*** obligation, imposes "an unwavering duty to act both

[32] Keith L. Johnson, Reinhart Boerner Van Deuren s.c., "Fiduciary Duty and ESG Engagement". https://www.reinhartlaw.com/wp-content/uploads/2016/01/Fiduciary-Duty-and-ESG-Engagement.pdf.
[33] Max M. Schanzenbach Robert H. Sitkoff, Working Paper, "Did Reform of Prudent Trust Investment Laws Change Trust Portfolio Allocation?". http://www.law.harvard.edu/programs/olin_center/papers/pdf/Schanzenbach_Sitkoff_580.pdf.
[34] Keith L. Johnson, Reinhart Boerner Van Deuren s.c., "Fiduciary Duty and ESG Engagement". https://www.reinhartlaw.com/wp-content/uploads/2016/01/Fiduciary-Duty-and-ESG-Engagement.pdf.
[35] Restatement of Trusts (Third) §227, Introduction (1992).
[36] Donovan v. Cunningham, 716 F.2d 1455, 1467, 4 EBC 2329 (5th Cir. 1983). https://casetext.com/case/donovan-v-cunningham#38056fda-7f5d-4db6-9850-39667232cffd-fn16.

as a prudent person would act in a similar situation" and "with single-minded devotion" to those same plan participants and beneficiaries. Finally, an ERISA fiduciary must "act for the exclusive purpose" of providing benefits to plan beneficiaries. The court continued, "When enforcing these duties, the court focuses not only on the merits of the transaction, but also on ***the thoroughness of the investigation into the merits of the transaction***."

Further, *Donovan v. Cunningham*[37] noted that **"the test of prudence – the Prudent Man Rule – Is one of conduct, and not a test of the result of performance of the investment**. The focus of the inquiry is **how the fiduciary acted in his selection of the investment, and not whether his investments succeeded or failed**."[38] Thus, any review of compliance with ERISA's prudence requirements should be based upon a review of the ***procedural steps*** the fiduciary followed, i.e., procedural prudence, under **the then prevailing facts and circumstances**.

Based on the above, we believe that any new regulatory text should be aimed at improving procedural prudence and prevailing market standards given prevailing trends and market knowledge, which would include ESG coverage. Instead of a static interpretation of ERISA, the DOL would better serve pension fund beneficiaries by encouraging the adoption of ESG factors to achieve stable, risk-adjusted returns over the long-term.

The proposed rule also applies an inadequate analysis of ERISA text by ignoring the duty of impartiality, a component of the duty of loyalty which includes an obligation to identify and fairly balance conflicting interests of different beneficiary groups, including those of younger and older generations. This makes short-term earnings, long-term wealth creation and risk exposures over both time frames equally important for long-term investors. The US Supreme Court confirmed that the duty of impartiality applies to ERISA[39] and in this regard, proposing regulatory text which may discriminate against long-term investment objectives could lead to a breach of the duty of impartiality.

5. **The proposed rule would lead to confusion and hardship among pension funds that have already adopted widely accepted value-based ESG strategies in an effort to enhance risk adjusted returns, including thematic investments, best-in-class customization, ESG integration, normative based screening and active ownership.** The proposed rule ignores the fact that ESG has become an integral and inseparable part of professional long-term investment practice and presents fiduciaries with a false choice – that they must decide between ESG considerations or financial returns, when in fact it is widely understood that the two are intertwined. The market already recognizes it is not necessary to invest in companies that pollute the environment, employ child labor, or engage in corrupt business practices to generate appropriate risk-adjusted returns, and prudent investors are taking steps to eliminate such companies from their portfolios. It makes little sense that the

[37] *Ibid*.
[38] *Ibid*.
[39] Keith L. Johnson, Reinhart Boerner Van Deuren s.c., "Fiduciary Duty and ESG Engagement". https://www.reinhartlaw.com/wp-content/uploads/2016/01/Fiduciary-Duty-and-ESG-Engagement.pdf.

proposed rule should impose tests and barriers that could discourage fiduciaries from taking such steps.

In its 2015 Interpretative Bulletin the DOL stated a concern that previous guidance had unduly discouraged pension fund fiduciaries from including ESG considerations in their investment decision-making and introduced language that encouraged its application. The Bulletin states: "The Department believes that in the seven years since its publication, IB 2008–01 has unduly discouraged fiduciaries from considering ETIs and ESG factors. In particular, the Department is concerned that the 2008 guidance may be dissuading fiduciaries from (1) pursuing investment strategies that consider environmental, social, and governance factors, even where they are used solely to evaluate the economic benefits of investments and identify economically superior investments, and (2) investing in ETIs even where economically equivalent. Some fiduciaries believe the 2008 guidance sets a higher but unclear standard of compliance for fiduciaries when they are considering ESG factors or ETI investments."

The current proposed regulatory retraces the steps taken by the DOL in the past and actively discourages the consideration of ESG data. While not prohibiting ESG, the text makes it clear that fiduciaries would be hard pressed to adopt widely accepted ESG investment practices. The DOL states that it does not intend to increase fiduciaries' burden of care relative to ESG considerations, but in practical terms including ESG investing could be risky for fiduciaries, as they need to prove that there is not an economically indistinguishable alternative available, something they do not have to do for other investment strategies.

We believe that rather than undermining ESG practice, the proposed rule should target ambiguities and uncertainties that are associated with ESG practices. Sterilizing the investment process against ESG is a regressive approach, particularly when the entire market and industry is increasingly focused on delivering greater ESG certainty and rigor in the investment process.