United States Senate
WASHINGTON, DC 20510

July 30, 2020

The Honorable Eugene Scalia
Secretary
U.S. Department of Labor
200 Constitution Ave. NW
Washington, DC 20210

Re: Financial Factors in Selecting Plan Investments (RIN 1210-AB95)

Dear Secretary Scalia:

We write to express our serious concern with the Department of Labor's (the "Department") proposal relating to financial factors in selecting plan investments, specifically a fiduciary's consideration of environmental, social, or governance ("ESG") factors in ERISA-governed retirement plans.[1] This rushed and out-of-touch proposal relies on speculation rather than evidence to justify its misguided approach and would undermine fiduciaries' ability to consider all available information and make sound investments. Accordingly, we urge you to withdraw the proposed rule for the reasons outlined below.

ESG Strategies Have Historically Performed at Least as Well as Traditional Investments.

Though the Department assumes throughout the proposed rule that ESG investments sacrifice returns to achieve non-pecuniary goals, the Department does not offer evidence demonstrating such inferior performance and ignores an abundance of evidence demonstrating that ESG investing compares favorably to traditional investments in performance and risk.[2] Moreover, there is considerable analysis confirming ESG investments have outperformed traditional investments in recent years.[3] It is clear that plan fiduciaries selecting ESG investments can do well by doing good even as they meet ERISA's high fiduciary standards.

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[1] U.S. Dep't of Labor, Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 39113 (proposed June 30, 2020) (to be codified at 29 C.F.R. pt. 2550).

[2] *See, e.g.*, *Sustainable Reality*, MORGAN STANLEY (Aug. 2019), https://www.morganstanley.com/content/dam/msdotcom/ideas/sustainable-investing-offers-financial-performance-lowered-risk/Sustainable_Reality_Analyzing_Risk_and_Returns_of_Sustainable_Funds.pdf (finding "sustainable funds provided returns in line with comparable traditional funds while reducing downside risk"); Elizabeth Schulze, *'Sustainable' investors match the performance of regular investors, new IMF research finds*, CNBC (Oct. 10, 2019), https://www.cnbc.com/2019/10/10/imf-research-finds-esg-sustainable-investment-funds-dont-underperform.html (citing a study from the International Monetary Fund that "found the performance of 'sustainable' funds is comparable to that of conventional equity funds").

[3] *See, e.g.*, John Hale, *U.S. ESG Funds Outperformed Conventional Funds in 2019*, MORNINGSTAR (Apr. 16, 2020), https://www.morningstar.com/articles/973590/us-esg-funds-outperformed-conventional-funds-in-2019 ("The returns of 35% of sustainable funds placed in the top quartile of their respective categories, and nearly two thirds finished in the top two quartiles."); Siobhan Riding, *Majority of ESG funds outperform wider market over 10 years*, FIN. TIMES (June 13, 2020), https://www.ft.com/content/733ee6ff-446e-4f8b-86b2-19ef42da3824 ("Close to six out of 10 sustainable funds delivered higher returns than equivalent conventional funds over the past decade, according to a

In the first four months of this year – in an incredibly volatile market – the S&P 500 ESG index outperformed the normal S&P index, and an estimated 88 percent of global ESG indexes outperformed their standard counterparts.[4] Studies of the outperformance of ESG funds indicate ESG funds are less volatile and more resilient to economic downturns due to a range of material ESG characteristics, including employee job satisfaction, quality customer relations, or an effective and active board.[5] Additionally, the period of economic turmoil caused by the coronavirus pandemic has seen investors increasingly rebalancing their portfolios, preferring sustainable funds over traditional ones, accelerating the trend in preferences toward ESG funds and further increasing the resiliency of such funds.[6] Taken together, these data, in fact, suggest investors and advisors who do not take ESG factors into account may be violating their fiduciary responsibility by not weighing ESG factors that could improve the performance of their funds.

The Prohibition of ESG Funds as a Qualified Default Investment Alternative ("QDIA") or a Component of One is Arbitrary and Contradictory.

In its proposal, the Department simultaneously proclaims that "ERISA is a statute whose overriding concern . . . has always been providing a secure retirement for American workers and retirees," while also asserting ESG funds, "even if selected by fiduciaries only on the basis of objective risk-return criteria," are not appropriate for a default investment option.[7] The proposal does not provide a rationale for prohibiting the use of an ESG fund as a QDIA[8] or a component of one, even where the fund may meet all other relevant fiduciary considerations. Rather, the Department imposes its unsupported belief that "it is inappropriate for participants to be defaulted into a retirement savings fund with other objectives absent their affirmative decision."[9]

This belief stands in stark contrast to the Department's recent information letter confirming private equity can be a permissible component of asset allocation funds, such as target-date funds in 401(k)-type plans, even though such investments have higher risk, a lack of transparency, and

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study that undermines claims that investing based on environmental, social and governance principles hampers performance."); Michael Copley, Esther Whieldon & Robert Clark, *ESG funds remain relative safe havens in coronavirus downturn*, S&P GLOB. (May 19, 2020), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/esg-funds-remain-relative-safe-havens-in-coronavirus-downturn-58679570 ("S&P Global Market Intelligence analyzed 17 exchange-traded and mutual funds with more than $250 million in assets under management that select stocks for investment based in part on ESG criteria. Of those funds, 14 have lost less value this year than the S&P 500.").

[4] Gillian Tett, *Why ESG Investing Makes Fund Managers More Money*, FIN. TIMES (July 9, 2020) https://www.ft.com/content/1cfb5e02-7ce1-4020-9c7c-624a3dd6ead9.

[5] *Sustainable Investing: Resilience Amid Uncertainty*, BLACKROCK (2020), https://www.blackrock.com/corporate/literature/investor-education/sustainable-investing-resilience.pdf.

[6] *Id.*

[7] Financial Factors in Selecting Plan Investments, 85 Fed. Reg. at 39119.

[8] A Qualified Default Investment Alternative ("QDIA") is a default investment that is used when a participant in a 401(k) plan has not made an investment election. Plan fiduciaries select a QDIA, and such selection is governed by DOL regulations. *See* 29 C.F.R. § 2550.404c-5.

[9] Financial Factors in Selecting Plan Investments, 85 Fed. Reg. at 39119.

higher fees.[10] Considering this disparate treatment of ESG and private equity investments, the Department appears to base its proposals on ideological concerns rather than evidence-based rulemaking.

Further, the Department notes "[t]here is no consensus about what constitutes a genuine ESG investment," yet proffers an unworkable prohibition on the inclusion of ESG funds as a QDIA or a component of one.[11] This raises a number of questions and challenges for plan fiduciaries. If it is unclear what constitutes this type of investment, would the lack of clarity preclude a plan fiduciary from including a fund that contains the mere mention of ESG factors in its prospectus? Would the lack of clarity preclude a plan fiduciary from including a fund that invests based on ESG factors based on its long-term perspective, but does not identify itself as an ESG fund? How would a prudent fiduciary even know about this, making this a trap for plan fiduciaries? How would a plan fiduciary know if a factor considered by a QDIA was a prohibited ESG factor or a permissible factor that a prudent fiduciary should (and perhaps must) consider? This lack of specificity could lead to the unintended consequence of driving plan fiduciaries from the most prudent investment, based on pecuniary factors, to a lesser alternative if the prospectus or other investment disclosure makes a passing reference to ESG factors. It could also drive fiduciaries away from prudent funds that take long-term trends into account, potentially in contradiction of the plain language of ERISA[12] and the Department's own QDIA regulations.[13] It is unfair and nonsensical for the Department to prohibit a practice like ESG investing while admitting it cannot define the practice it is prohibiting, and such a vague rule would raise serious enforceability questions.

ESG Considerations are Appropriate Tie-Breakers.

The Department suggests the current "all things being equal test" may permit fiduciaries to abdicate their fiduciary duties without a proper analysis to justify the selection of a fund based on non-pecuniary factors.[14] If true, fiduciaries would have breached their obligations to the plan and could be held accountable for such actions. Provided similar, prudent investment alternatives otherwise meet a fiduciary's rigorous evaluation, non-pecuniary factors should continue to be allowed to break ties.

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[10] U.S. Dep't of Labor, Information Letter to Jon Breyfogle (June 3, 2020), https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/information-letters/06-03-2020. Notably, the proposal highlights that "ESG funds often come with higher fees, because additional investigating and monitoring are necessary to assess an investment from an ESG perspective," Financial Factors in Selecting Plan Investments, 85 Fed. Reg. at 39115, while fees are not mentioned in the Information Letter.

[11] Financial Factors in Selecting Plan Investments, 85 Fed. Reg. at 39115.

[12] Employee Retirement Income Security Act § 404(c)(5), 29 U.S.C. § 1104(c)(5) (2018) ("The regulations under this subparagraph shall provide guidance on the appropriateness of designating default investments that include a mix of asset classes consistent with capital preservation or *long-term capital appreciation*, or a blend of both") (emphasis added).

[13] *See, e.g.*, U.S. Dep't of Labor, Default Investment Alternatives Under Participant Directed Individual Account Plans, 72 Fed. Reg. 60452, 60461 (Oct. 24, 2007) (codified at 29 C.F.R. pt. 2550) ("[T]he final regulation . . . continues to require that the qualified default investment alternatives . . . be designed to provide degrees of long-term appreciation and capital preservation.").

[14] Financial Factors in Selecting Plan Investments, 85 Fed. Reg. at 39117.

The subjective nature of a fiduciary's decision in the application of the "all things being equal" test, when coupled with the Department's expressed skepticism toward the test, will likely discourage plan fiduciaries from investing in such ESG funds. An administration hostile to ESG investing could increase enforcement actions, thereby increasing risk to the plan. In fact, multiple regional offices of the Employee Benefits Security Administration ("EBSA") recently sent certified letters - which are not the usual subpoenas for the Department - requesting extensive information relating to the recipient plan's ESG investments.[15] While it has been suggested the Department is simply gathering data to support this rulemaking, plans received these letters after this proposal was submitted for review to the Office of Management and Budget.[16] If the material EBSA requested was intended to inform this rulemaking, it should have been collected and reviewed the data in advance of the proposal's release. These letters therefore appear intended to preemptively – and inappropriately under the Administrative Procedure Act - discourage plans from engaging in ESG investing before this proposal is finalized.

It is Prudent for Pension Fiduciaries to Consider Environmental Risks Like Climate Change.

While the Department issued this proposal under the guise of protecting the financial interests of ERISA plan participants, it was mandated by an Executive Order on Promoting Energy Infrastructure and Economic Growth.[17] Specifically, this Executive Order called on the Department to "complete a review of available data filed with the Department of Labor by retirement plans subject to the Employee Retirement Income Security Act of 1974 (ERISA) in order to identify whether there are discernable trends with respect to such plans' investments in the energy sector."[18]

It appears the Administration is attempting to undermine decades of environmental regulation and progress by targeting the role of domestic capital markets in financing infrastructure projects. Discouraging ESG investments will not, however, stop the energy sector from changing – based on both economic concerns and an increased desire for renewable energy.[19] This proposal is misguided if the Administration believes it will reverse these larger energy trends.

Regardless of the impetus for this proposal, the Department indicates it questions the motives of plan fiduciaries in considering ESG factors. As the Department explains in the proposal, "an ERISA fiduciary's evaluation of plan investments must be focused solely on economic considerations that have a material effect on the risk and return of an investment based on appropriate investment horizons, consistent with the plan's funding policy and investment policy objectives."[20]

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[15] Nevin E. Adams, *UPDATE: EBSA Probing ESG Holdings, Policies*, NATIONAL TAX-DEFERRED SAVINGS ASSOCIATION (June 15, 2020), https://www.ntsa-net.org/news-resources/update-ebsa-probing-esg-holdings-policies.
[16] *Id.*
[17] Promoting Energy Infrastructure and Economic Growth, Exec. Order No. 13868, 84 Fed. Reg. 15495 (Apr. 10, 2019), https://www.whitehouse.gov/presidential-actions/executive-order-promoting-energy-infrastructure-economic-growth/.
[18] *Id.*
[19] Keith Johnson, *Trump Can't Save Coal Country*, FOREIGN POL'Y (Oct. 30, 2019), https://foreignpolicy.com/2019/10/30/trump-save-coal-country-murray-bankruptcy-gas/.
[20] Financial Factors in Selecting Plan Investments, 85 Fed. Reg. at 39116.

Pension plans can and should invest with a long-term outlook, and environmental factors are critical considerations for long-term investing. In a report discussing the investment perspective of climate change, it was noted that "[t]he value of global financial assets at risk from climate change has been estimated at US $2.5 [trillion] by the London School of Economics and US $4.2 [trillion] by the *Economist*."[21] Evaluating ESG factors like climate change can have a material effect on the risk and return of pension assets on an appropriate time horizon. Accordingly, the use of ESG factors as a method of assessing and mitigating risk in retirement investments is a prudent consideration in meeting ERISA's fiduciary obligations.

The Department should be using its authority to ensure pension assets are protected long-term from the significant risks posed by climate change. This could be accomplished by promoting sustainable investing and encouraging ERISA fiduciaries to consider longer-term risk in their investment evaluations. Instead, the Department has sacrificed the long-term financial and existential interests of retirement savers for a short-term, political gain in the energy sector.

This is the Wrong Time to Eliminate a Tool to Address Systemic Racism.

The disparate racial impacts of the coronavirus pandemic and societal backlash against police brutality have created an inflection point in the fight against systemic racism in our country. While this proposal would not be welcome at any time, it is especially wrong now, as people across the country are demanding accountability and using every means possible to address systemic racism. ESG investing is widely and increasingly used by investors and advisers to reward corporate values of racial inclusion, diversity, and equity.[22] As a result of shareholder initiatives and other ESG engagement efforts, many companies have begun disclosing ESG-related metrics, such as pay disparity information and percentages of management and employees by gender and race, and a growing number of companies and funds are considering how to alter their current internal and external practices toward addressing ESG priorities.[23] By discouraging such investments, the Department would weaken an effective tool that can be used to drive social change.

The Department has Directly Interfered with other Governmental Retirement Investments Based on Non-Pecuniary Factors.

The Department proclaims that "[p]roviding a secure retirement for American workers is the paramount, and eminently-worthy, 'social' goal of ERISA plans [and] plan assets may not be enlisted in pursuit of other social or environmental objectives."[24] Though the Department claims here that ESG factors can hurt ERISA plan participants, the Department has shown its

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[21] *Climate change: The investment perspective*, EY (2016), https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/banking-and-capital-markets/ey-climate-change-and-investment.pdf.
[22] Paul Sullivan, *How Investors Are Addressing Racial Injustice*, N.Y. TIMES (July 2, 2020), https://www.nytimes.com/2020/07/03/your-money/investors-racial-injustice.html.
[23] Adam Emmerich, D. Silk & S. Niles, *Using ESG Tools to Help Combat Systemic Racism and Injustice*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 17, 2020), https://corpgov.law.harvard.edu/2020/06/17/using-esg-tools-to-help-combat-systemic-racism-and-injustice/.
[24] Financial Factors in Selecting Plan Investments, 85 Fed. Reg. at 39115–16.

willingness to intervene in the case of federal workers to directly interfere with their retirement investments based on non-pecuniary factors.

In May, as the Department was finalizing this proposal, you wrote a letter to the Federal Retirement Thrift Investment Board ("FRTIB") directing the members of the independent board to abandon the new international benchmark fund due to "significant national security and humanitarian concerns."[25] The members of the FRTIB, who serve as plan fiduciaries to the Thrift Savings Plan, selected this new international fund in November 2017 to improve the performance of the fund's investments for the benefit of plan participants.[26] In doing so, the members of the FRTIB executed their fiduciary responsibilities with "an eye single to the interests of the participants and beneficiaries."[27] The Department in its letter did not suggest the FRTIB failed to meet its fiduciary obligations, but rather issued an order based on non-pecuniary issues important to the Administration.

This intervention is not the first time. The Administration took a similar position with respect to the participants and beneficiaries of the Railroad Retirement Board.[28] In highlighting these cases, we are not questioning these decisions, but rather pointing out an inconsistency in that the Administration explicitly has taken ESG factors into account to benefit both federal workers and the world.

The limited analysis you provided in issuing these orders, which is hardly the "fact-specific" analysis that would be required by an ERISA fiduciary under the proposed rule, raises questions that should be addressed in any final rule. Would it be sufficient for a plan fiduciary to rely on the assertion of government officials that a specific type of investment raises risks such that a fiduciary is obligated to divest such investments, as you suggested to the federal retirement plans? It seems nonsensical to be ordering some plan fiduciaries to divest on the basis of humanitarian and national security concerns while just weeks later proposing a rule to tie the hands of other plan fiduciaries who may choose to consider the same factors.

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[25] Letter from Eugene Scalia, Sec'y of Labor, U.S. Dep't of Labor, to Michael Kennedy, Chairman, Fed. Ret. Thrift Inv. Bd. (May 11, 2020), https://federalnewsnetwork.com/wp-content/uploads/2020/05/051220_scalia_frtib_letter_FNN.pdf (directing the FTIB fiduciaries to halt investment in MSCI ACWI ex USA IMI despite a 5.02% gross return since inception due to "significant national security and humanitarian concerns").

[26] Thomas Franck, *White House directs federal pension fund to halt investments in Chinese stocks*, CNBC (May 12, 2020), https://www.cnbc.com/2020/05/12/white-house-directs-federal-pension-fund-to-halt-investments-in-chinese-stocks.html; *see also* Aon Hewitt, *I Fund Policy Benchmark Review*, FED. RET. THRIFT INV. BD. (Oct. 28, 2019), https://www.frtib.gov/pdf/minutes/2019/Oct/MM-2019Oct-Att2.pdf.

[27] Financial Factors in Selecting Plan Investments, 85 Fed. Reg. at 39114.

[28] Letter from Robert O'Brien, Assistant to the President for Nat'l Sec. Aff., and Lawrence Kudlow, Dir., Nat'l Econ. Council, to Erhard Chorle, Chairman of R.R. Ret. Bd. (July 7, 2020) (on file with the author) (citing "economic, national security, and humanitarian concerns" as the rationale to push the National Railroad Retirement Trust to reconsider its investments in companies from the People's Republic of China).

The Regulatory Impact Analysis is Inadequate.

The Regulatory Impact Analysis ("RIA") in the proposed rule falls well short of the analyses you championed in private practice when challenging regulations issued by the Securities and Exchange Commission and the Commodity Futures Trading Commission.[29] We refer you to your advice to the SEC: "[R]egulators should be particularly attentive to the financial consequences of their actions."[30] But that does not appear to be the case in this instance.

As currently drafted, the RIA is merely a collection of assertions, declarations, and speculation lacking analysis or robust evidence to justify this proposal. The Department states its belief that the proposed rule will cause some fiduciaries to make investment choices that are different from those they would have selected prior to such rule.[31] The Department then makes a curious and baseless prediction that "[t]hese selected investments' returns will generally tend to be higher over the long run."[32] The Department offers no factual rationale for this prediction. Given its highly speculative nature, it is inappropriate to substitute guesswork for an analysis to determine whether the costs of this proposal outweigh its benefits—especially when even a cursory analysis of the actual data refutes this flawed hypothesis.

As discussed in greater detail above, ESG funds have outperformed traditional investments over the past several years.[33] However, there is no mention of such facts in the RIA. Instead, the Department highlights a survey that suggests "individual investors expect socially responsible investing mutual funds to have lower returns and higher fees than conventional mutual funds."[34] A survey of investors' expectations is not sufficient evidence to justify the Department's proposal, particularly when there is data available regarding performance. The Department asserts it "believes that the rule's benefits would exceed its costs."[35] An RIA cannot comprise an analysis built on beliefs. Rather, an agency must show economic evidence to justify reasoned decision-making, both of which are lacking in this proposal.

Conclusion

For the myriad reasons discussed above, we strongly urge you to withdraw this harmful and unsupported proposed rule immediately. We further urge the Department to abandon its recent, aggressive political rulemaking agenda and focus instead on pursuing policies that will have a meaningful impact on the millions of families in this country struggling with record unemployment or forced to work in unsafe and unhealthful working conditions. To start, we again demand you immediately use your existing authority under the Occupational Safety and Health Act to issue an emergency temporary standard for infectious disease, and you educate

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[29] *See, e.g.*, Eugene Scalia, *Why Dodd-Frank Rules Keep Losing in Court*, WALL ST. J. (Oct. 3, 2012), https://www.wsj.com/articles/SB10000872396390444004704578032223012816236.
[30] *Id*.
[31] Financial Factors in Selecting Plan Investments, 85 Fed. Reg. at 39121.
[32] *Id.*
[33] Siobhan Riding, *Majority of ESG funds outperform wider market over 10 years*, FIN. TIMES (June 13, 2020), https://www.ft.com/content/733ee6ff-446e-4f8b-86b2-19ef42da3824.
[34] Financial Factors in Selecting Plan Investments, 85 Fed. Reg. at 39120.
[35] *Id.*

workers on their rights to paid sick and family leave during this ongoing public health emergency.

Sincerely,

PATTY MURRAY
United States Senator

TINA SMITH
United States Senator

ELIZABETH WARREN
United States Senator

RICHARD J. DURBIN
United States Senator

SHERROD BROWN
United States Senator

CORY A. BOOKER
United States Senator

BRIAN SCHATZ
United States Senator

MAZIE K. HIRONO
United States Senator

AMY KLOBUCHAR
United States Senator

SHELDON WHITEHOUSE
United States Senator

cc: Jeanne Klinefelter Wilson, Acting Assistant Secretary,
Employee Benefits Security Administration