

December 10, 2021

The Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, DC 20210

Attention: Prudence and Loyalty in Selecting Plan Investments
and Exercising Shareholder Rights

Submitted via Electronic Delivery

**Re: RIN 1210-AC03 – Prudence and Loyalty in Selecting Plan Investments
and Exercising Shareholder Rights**

Ladies and Gentlemen:

Federated Hermes, Inc. (“Federated Hermes”) appreciates the opportunity to comment on the Department of Labor’s (the “Department”) notice of proposed rulemaking (“Proposal”) regarding amendments to the Investment Duties regulation under Title I of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”) to clarify the application of ERISA’s fiduciary duties of prudence and loyalty in selecting investments and investment courses of action, including exercising shareholder rights, and believes that the Proposal is generally a positive development for ERISA fiduciaries and the workers they represent.

Who We Are

Federated Hermes is a global investment manager of more than \$600 billion in assets and has been focused on fiduciary principles for over 50 years. Since that time, Federated Hermes has been meeting the investment needs of fiduciaries who advise or manage assets for their clients. Fiduciary duty is central to our understanding of our role as stewards of our clients’ assets, and we take that responsibility very seriously.

Even as we have grown and expanded our offerings to include a broad range of investment strategies—from liquidity solutions to high active share global and regional equities to active credit and private markets—our core principle remains the same: meeting the financial needs of our clients. In 2018, we acquired Hermes Investment Management, a London-based pioneer of ESG investing and stewardship to expand our understanding of ESG investing in order to help improve risk-adjusted return outcomes for investors. This expanded expertise enables us to support our clients’ keen interest in understanding the implications of integrating the consideration of ESG factors into prudent investment processes.

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Given our role as a global investment firm and our experience with ESG-integrated investment processes, we support the Department's efforts to further clarify how ERISA fiduciaries may prudently consider ESG factors when selecting an investment or investment course of action and generally support the Proposal as drafted; however, certain aspects of the Proposal seem to go beyond clarification, and could be read in a way that would require ERISA fiduciaries to consider ESG factors as material factors independent of the fiduciary's own prudent analysis.

Our concern is that these elements of the rule and release will unnecessarily subject ERISA fiduciaries to regulatory and litigation risk and expose any final rulemaking to further scrutiny over time. We believe slight modifications to the Proposal would address the Department's purposes for the Proposal and mitigate these risks.

In addition, we have comments on the Proposal's changes to the recordkeeping requirements as further described below to address similar concerns.

Investment Prudence Duties

We are supportive of ESG investing being subject to the same fiduciary principles of loyalty and prudence that are applicable to any type of investment. One of the most significant changes in the Proposal is the regulatory text stating that the prudent fiduciary analysis of an investment "may often require an evaluation of the economic effects of climate change and other ESG factors on the particular investment or investment course of action."¹

While we understand that this provision is intended to counteract negative perception of the use of ESG factors in investment decisions attributed to the Department's prior rulemaking (the "2020 Rule")², using the qualifier "may often require" seems reads as an endorsement of ESG investing and casts a pall over other investment approaches. With this language, the Department seems to be "tipping the scales" in favor of fiduciary consideration of ESG factors over other factors, still subjecting ESG factors to special attention, but from the opposite perspective of the 2020 Rule. This particular focus is unnecessary and could confuse fiduciaries into thinking they should or even must consider ESG factors as relevant to any particular investment or investment course of action, regardless of the fiduciary's particular knowledge, or otherwise face increased exposure to regulatory action or litigation. We are also concerned that the language would be controversial enough to subject it to future Department review and modification, thereby counteracting the Proposal's goal of providing ERISA fiduciaries with additional clarity in utilizing ESG factors.

¹ § 2550.404a-1(b)(2)(ii)(C) of 29 CFR 2550.404a-1

² "Financial Factors in Selecting Plan Investments," 85 FR 72846 (November 13, 2020)

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We believe the appropriate middle-ground here is to amend the language to read “which may include, but is not limited to, an evaluation of ESG factors, such as the economic effects of climate change, on the particular investment or investment course of action.” This language still signals an acceptance of the consideration of ESG factors without implying a bias toward such factors over other factors.

Similarly, with respect to the proposed addition of the specific examples of ESG risks that may be material to a fiduciary’s risk-return analysis³, our concern is that the only examples provided in the Proposal are ESG-related, which may be misconstrued as a preference or endorsement by the DOL. We suggest either eliminating the examples from the regulatory text altogether and utilizing them in the Preamble or adding examples of non-ESG factors that also may be material to the analysis.

Investment Loyalty Duties

The Proposal removes the language concerning the enhanced recordkeeping/documentation requirements in the 2020 Rule related to the consideration of collateral benefits under the so-called “tie-breaker.”⁴ The proposing release states that this was done because the requirements “singled out and created burdens specifically for investments providing collateral benefits, which many perceived as targeting ESG investing.” The Department believes the requirements were “too formulaic” and that documentation depends upon the individual facts and circumstances. Further, the Department’s view is that “a special documentation requirement is unnecessary given that fiduciaries are subject to a general prudence obligation and commonly document and maintain records about their investment selections pursuant to that obligation.”

While we agree with the removal of the formulaic requirements, we note that decision-making situations that require enhanced documentation were familiar features of fiduciary practice prior to the 2020 rule. In a tie-breaker situation, the fiduciary is presented with a potential conflict of interest relating to benefits accruing from the investment decision. In such a situation, the Restatement of Trusts (which courts will look to in evaluating a fiduciary duty) is generally understood by fiduciaries to require enhanced recordkeeping. We are concerned that this change may mislead fiduciaries and make them vulnerable to regulatory and litigation risk. We propose that any final rulemaking either include a general statement in the rulemaking regarding prudent recordkeeping, or a deeper discussion in the Preamble of the practical need for enhanced records when enhanced decision-making is performed by the fiduciary.

³ § 2550.404a-1(b)(4)(i-iii)

⁴ § 2550.404a-1(c)(3)

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Proxy Voting and Exercise of Shareholder Rights

Federated Hermes agrees that a fiduciary must comply with the prudence and loyalty duties under ERISA when exercising proxy voting and other shareholder rights and we support the provisions of the Proposal that reinstate control over voting rights to the fiduciary subject to prudent process.

We note however, that like the tie-breaker rule, the Proposal eliminates a requirement from the 2020 Rule that mandated fiduciaries maintain records on proxy voting activities and the exercise of other shareholder rights, on the basis that general fiduciary standards are sufficient to cause fiduciaries to maintain appropriate records. We have similar concerns that this change may provide a false sense of security to fiduciaries and make them vulnerable to regulatory and litigation risk. Here too, we propose that any final rulemaking include a general statement in the rulemaking regarding prudent recordkeeping.

Conclusion

Federated Hermes supports the premise of the Proposal, as it has supported the prior guidance issued by the Department, that ERISA does not permit investment fiduciaries to subordinate the long-term economic interests of participants in their retirement plans to collateral goals, and that proper integration of ESG factors can be consistent with prudent ERISA fiduciary processes. We believe, with the slight modifications as described above, that the rulemaking will be very beneficial to the retirement industry, fiduciaries, and workers alike.

We would be happy to meet with you at your convenience to discuss these or any other issues related to the Proposal, and we look forward to working with you to strengthen ERISA's fiduciary protections.

Sincerely,



Peter J. Germain
Chief Legal Officer