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Fred Wong
Acting Chief of the Division of Regulations
United States Department of Labor
Employee Benefits Security Administration
Office of Regulatory Interpretations, Room N-5665
200 Constitution Avenue, NW
Washington, DC 20210
Attention: Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights
Docket ID: RIN 1210-AC03

Comments submitted by Theodore H. Frank and the
Hamilton Lincoln Law Institute in Response to "Proposed Rule:
Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder
Rights," RIN 1210-AC03, 86 Fed. Reg. 57272 (Oct. 14, 2021)

Dear Mr. Wong:

Thank you for the opportunity to comment on the Department of Labor's proposed rule on Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, which proposes to revise 29 CFR § 2550.404a-1, Investment Duties. 86 Fed. Reg. 57272 (Oct. 14, 2021). We believe that the proposed rule conflicts with the plain language and intent of ERISA Section 404; creates an unworkable subjective standard that undermines fiduciary accountability; undermines fiduciary accountability in other ways; and is outside the scope of ERISA. The Department of Labor should withdraw the proposed rule.

The Department proposed the rule in response to Executive Order 13990, Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis, 86 Fed. Reg. 7037 (January 25, 2021), and Executive Order 14030, Executive Order on Climate-Related Financial Risk, 86 Fed. Reg. 26967 (May 25, 2021). The proposed rule purports to replace two recently adopted 29 CFR Part 2550 rules, Financial Factors in Selecting Plan Investments, 86 Fed. Reg. 72846 (Nov. 13, 2020), and Fiduciary Duties Regarding Proxy Voting and Shareholder Rights, 85 Fed. Reg. 81658 (Dec. 16, 2020). It is worth noting that Congress declined to use the Congressional Review Act to rescind these rules, despite the administration's party holding majorities in both chambers.

The Hamilton Lincoln Law Institute, which I co-founded, is a nonprofit public-interest law firm dedicated to, among other things, principles of protecting consumers and shareholders and pension beneficiaries from conflicts of interest, limited constitutional government, and the free market. For over the last twelve years, my attorneys and I have litigated on behalf of consumers and shareholders and pension beneficiaries against conflicts of interest. The proposed rule encourages conflicts of interest, undermines fiduciary accountability, and is *ultra vires*.

I. **The proposed rule contradicts section 404, which mandates that fiduciaries focus solely on financial benefits.**

"ERISA codifies the trust law sole interest rule by mandating that a pension trustee act 'solely in the interest of participants and beneficiaries" and for the "*exclusive* purpose" of "providing benefits" to them. Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience*, 72 Stan. L. Rev. 381, 403 (2020) (quoting *Tibble v. Edison International*, 575 U.S. 523, 525, 527 (2015) and 29 U.S.C. § 1104(a)(1)(A)(i)). In *Fifth Third Bancorp v. Dudenhoeffer*, the Court emphasized that the underlying aim of the sole interest or exclusive benefit rule is to protect "financial benefits" for plan beneficiaries. 573 U.S. 409, 421 (2014). *Dudenhoeffer* involved an allegation of breach of the exclusive benefit rule over management of an Employee Stock Ownership Plan (ESOP), a retirement investment vehicle that by its nature incorporates a collateral interest or motivation, promoting employee ownership of a corporation. The Court nonetheless found Section 404 mandates that, even in the context of an ESOP, plan fiduciaries must comply with the exclusive benefit standard; and that a pension trustee breaches the duty of loyalty if the trustee acts other than to financially benefit the participants or beneficiaries. The rules that proposed rule replaces aligned with *Dudenhoeffer* and ERISA Section 404. The proposed rule does not because it unnecessarily injects collateral, non-financial ESG factors into the investment making process, as well as the exercise of shareholder rights.

II. <u>The proposed rule does not align with the legislative intent of ERISA.</u>

Congress enacted ERISA with the narrow objective of assuring the financial safety and security for retired workers. The proposed rule, however, invites ERISA fiduciaries, investment advisors and asset managers to wade into complex and sometimes conflicting public policy matters, and make investment decisions that may reflect their ESG policy preferences rather than focusing on what is in the best pecuniary or financial interests of ERISA plan participants and beneficiaries. That was not Congress's intent when it passed ERISA and included Section 404. Indeed, Congress rejected several ERISA provisions that would have encouraged socially desirable or socially responsible investing. *See* James D. Hutchinson and Charles G. Cole, *Legal Standards Governing Investment of Pension Assets for Social and Political Goals*, 124 U. PA. L. REV. 1340, 1365-67 (1980) (cataloging rejected legislative proposals as evidence of Congress's intent to narrow the scope of a fiduciary's discretion).

III. <u>The proposed rule replaces an objective exclusive financial benefit standard with no standard.</u>

Plan participants and beneficiaries have varied ESG interests and policy preferences. The one interest that plan participants and beneficiaries have in common—and what Congress designed ERISA and Section 404 to achieve—is that of a safe and secure financial retirement. By unnecessarily incorporating ESG factors into the duty of loyalty and duty of prudence the proposed rule permits fiduciaries a degree of latitude to consider EGS factors and perhaps substitute their own ESG policy preferences, rather than adhering to the narrow confines and more objective financial benefit standard of the exclusive benefit rule. The rule requires that fiduciaries make investment decision and exercise shareholder rights based on what will achieve the best risk-adjusted returns for pension plan participants and beneficiaries, without having to assess or consider collateral, non-pecuniary matters such as ESG factors. The proposed rule removes the narrow focus and invites deviation from the exclusive benefit rule, potentially to the detriment of the plan participant and beneficiaries. It is better to have fiduciaries remain focused on a more objective standard: which investments provide the best risk-adjusted returns for plan participants and beneficiaries along with the appropriate level of portfolio diversification. That is what Section 404 requires.

Use of ESG factors to assess investments is inherently flawed because there is no uniform or objective ESG standard by which to judge a company in which an ERISA fiduciary may invest. For instances, a company may have an exceptionally good environmental record and be a leader in reducing or minimizing its carbon footprint, but have flawed corporate governance such that it could be the next Enron. Similarly, a bank that scores high marks for environmental and social goals because it no longer serves the fossil fuels or firearms industries and has an excellent diversity and inclusion hiring record may have a terrible Community Reinvestment Act record. Who is to say which factor deserves more weight? Which factor is more important when assessing financial performance and risk-adjusted returns?

The flaw of using ESG factors in investment or shareholder rights decisions is further illustrated by studies that show that ESG investing has poor outcomes. The *Wall Street Journal* reported earlier this year that a study of exchange traded funds (ETFs) that have an ESG focus have 43 percent higher fees than other EFTs. Michael Wursthorn, *Tidal Wave of ESG Funds Brings Profit to Wall Street,* WALL ST. J., (March 16, 2021), available at https://www.wsj.com/articles/tidal-wave-of-esg-funds-brings-profit-to-wall-street-11615887004. The study by the Pacific Research Institute revealed that, over a ten-year period, $10,000 invested in an ESG fund would be about 44% lower than an investment in a fund or ETF that tracks the S&P 500 stock index. *Id.* Furthermore, the former head of sustainable investing at Blackrock, one of the world's largest asset managers, has stated that "the ESG industry today consists or products that have higher fees but little to no impact and narratives that mislead the public." William Power, *Does Sustainable Investing Really Help the Environment?* WALL ST. J. (Nov. 7, 2021), available at https://www.wsj.com/articles/sustainable-investing-good-for-environment-11636056370. Indeed, as a leading hedge-fund investor shows, simple economic theory teaches us that ESG investing is *expected* to have lower returns. Cliff Asness, *Virtue Is Its Own Reward: Or, One Man's Ceiling Is Another Man's Floor*, AQR INSIGHTS (May 18, 2017), available at https://www.aqr.com/Insights/Perspectives/Virtue-is-its-Own-Reward-Or-One-Mans-Ceiling-is-Another-Mans-Floor.

Public pension plans are not subject to ERISA and the rigid restrictions Section 404 puts on fiduciaries, but the experience of some public employee pension funds with Socially Responsible Investing (SRI), which has now evolved into ESG, also demonstrates the risk to pension plan participants and beneficiaries. *See* Schanzenbach & Sitkoff, *supra*, at 392-97 (summarizing the evolution of SRI to ESG). The experience of the California Public Employees Retirement System

(CalPERS) is illustrative. CalPERS has actively engaged in SRI within the past decade, which has resulted in it being in the bottom 1% of all pension funds. William Sanders, *Resolving the Conflict Between Fiduciary Duties and Socially Responsible Investing,* 35 PACE L. REV. 535, 541-42 (2014). Decisions to divest from tobacco stocks cost CalPERS $1 billion in missed profits and investments in clean energy resulted in a negative 9.7% return. *Id.* at 542. The exclusive benefit rule of Section 404 is intended to prevent such outcomes. The proposed rule, however, opens the door for such results while potentially shielding plan fiduciaries from accountability because it grants them far more latitude to consider ESG factors rather than focus exclusively on financial benefits.

IV. **The proposed rule undermines fiduciary accountability.**

The proposed rule purports to add clarification to fiduciary investment and corporate action decision as they relate to ESG factors, but the practical effect will be to impermissibly erode the exclusive benefit rule. The proposed rule unnecessarily injects ESG factors into investment decisions and provides cover for fiduciaries and their investment adviser or asset manager agents who consciously or otherwise assert their own ESG policy preferences yet will be able to avoid liability for not acting in the exclusive financial interests of plan participants and beneficiaries. This is not what Congress intended when it passed ERISA and Section 404.

Moreover, the proposed rule's elimination of the requirement that fiduciaries maintain records of corporate proxy voting also runs counter the exclusive benefit rule. It will deprive plan participants and beneficiaries of crucial information by which to judge whether fiduciaries are acting in their best interest and for their exclusive benefit. Without this mechanism for accountability, plan participants and beneficiaries will be able only to speculate on whether fiduciaries or their agents that exercise shareholder rights are substituting their own ESG policy preferences rather than acting in the exclusive financial benefit of the plan participants and beneficiaries.

V. **The underlying purpose of the proposed rule is outside the scope of ERISA.**

The multitude of potentially conflicting ESG factors, preferences and policy priorities are better addressed by Congress. The proposed rule will have the practical effect of outsourcing potentially significant ESG policy decisions to a comparatively small number of plan fiduciaries, asset managers, and investment advisors responsible for pension investment decisions or for exercising shareholder proxy rights. Many of these ESG issues are matters that are better left to the legislative process, rather than left in the hands of a small group of investment advisors and asset managers who manage vast sums of pension money.

If the financial impact of climate change is so great, then it is best to let Congress weigh in on the issue to either revise Section 404 or create alternatives within the ERISA statutory framework for pension plan participants and beneficiaries to voluntarily invest retirement money in investment vehicles that may potentially sacrifice risk-adjusted returns because of a preference for one or more ESG factors. Current fiduciary law outside the ERISA context permits this. *See* Schanzenbach & Sitkoff, *supra*, at 404, 411-418 (noting that pension law in the United Kingdom as well as general U.S. trust law permits using nonfinancial investment factors). Until then, the Department should refrain from formally injecting ESG factors into ERISA investment decisions and the exercise of shareholder rights and leave in place the existing rules that the proposed rule seeks to replace. Those rules, unlike the proposed rule, embody the more objective exclusive financial benefit standard mandated by Section 404.

VI. The underlying purpose of the proposed rule is arbitrary and capricious in the context of the administration's political actions demonstrating a lack of belief that climate change has existential consequences.

In reality, the Biden administration repeatedly signals that it is only interested in addressing climate change when it is politically popular to pretend to do so. For example, the administration refuses to even propose raising taxes on gasoline, and has taken policy steps to reduce the price of the carbon-intensive fuel by tapping the Strategic Petroleum Reserves and calling for OPEC to increase oil production. These are not the actions of an administration that genuinely believes that there is extensive climate-related financial risk. Ted Nordhaus & Morgan D. Bazilian, *Biden's Welcome Hypocrisy on Climate Policy*, WALL ST. J., (Aug. 26, 2021). Undermining the fiduciary accountability required by statute on grounds that the administration has demonstrated by its actions that it does not believe to be true is arbitrary and capricious.

Respectfully submitted,

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