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Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights

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Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights

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General Comment

Current estimates indicate nearly 140 million Americans participate in ERISA-regulated retirement plans, worth an estimated \$12.5 trillion. Given the magnitude of the assets under management, ERISA's governing legislation has the potential to drive material change in the broader capital markets while ensuring the security of future generations. The inverse is also true and any legislation which prevents appropriate management of investments has a ripple effect as the stringent fiduciary obligations require strict adherence to ERISA's standards, even if they are considered flawed based on the market's current evaluation of long-term risks. The proposed ruling - "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights" - removes artificial barriers placed around ESG factors, paving the way for them to more easily be implemented as material investment considerations.

While the language contained in the proposed ruling has explicit implications on the use of ESG factors in investment decisions, taken more broadly the adoption of the new pecuniary test - "fiduciary's evaluation of an investment or investment course of action must be based on risk and return factors that the fiduciary prudently determines are material to investment value, using appropriate investment horizons consistent with the plan's investment objectives and taking into account the funding policy of the plan" - enables investment managers to use all of the tools in their shed when considering new investments. Without broadening the language to allow for the consideration of any factor that is prudently determined to have a material impact on the investment, fund managers are stuck with one hand tied behind their back. As the new pecuniary test explicitly cross-references the ESG factors earlier in the ruling, if passed, this revision would allow for easier consideration of ESG elements when making investment decisions. Same goes for the broadening in scope of the "tie-breaker" test from use only where the investments are otherwise "economically indistinguishable" to those that "equally serve the financial interest of the plan over the appropriate time horizon".

Lastly, the return to encouraging proxy voting, unless the costs or other requirements outweigh the expected benefit of voting, restores a critical tool for investment managers in engaging actively with companies. Proxy voting allows investors to steer the organizations they are invested in towards outcomes which are more aligned with the interests of their fiduciary obligations, while mitigating against downside risk. Further, it allows companies to engage in more robust discussions with their active shareholders around their long-term strategy and financial goals, which are critical components to ensure the success of investments.

Taken in aggregate, I am fully in support of the new ruling as it allows for, and encourages, the use of ESG factors as material to the success of investments. The broader capital markets are increasingly shifting towards uniformly implementing ESG to investment criteria as more evidence emerges in support of the potential downside (and upside) risks associated with climate change, governance, and socio-political elements.

Environmental considerations may be the hardest to quantify given the rates at which climate change is affecting different areas of the world are constantly in flux due to inadequate research. However, this means taking a conservative approach when considering the impact of environmental factors is more important than ever to preserve the value of investments. Social and governance considerations may be easier to implement and gauge the impact of but that doesn't make them any less important. If an investment manager suspects checks and balances at a company are inadequate to prevent corruption, or the local community's attitude towards the construction of a new power plant may not be favorable, the manager should have the full support of the underlying legislation and investment criteria to evaluate these risks and prudently invest capital accordingly. Ultimately, to me this ruling puts trust back in the investment managers to responsibly manage the funds they have been hired to invest and enables them to dig in further on any factor they consider could be a material risk to the investment, a standard which seems obvious to encourage from my perspective.