July 30, 2020

Submitted electronically via regulations.gov

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

Re: RIN 1210-AB95, Financial Factors in Selecting Plan Investments Proposed Regulation

Dear Sir or Madam:

On behalf of the American Benefits Council ("the Council"), we are submitting this comment with respect to the above-referenced proposed regulation issued by the U.S. Department of Labor (DOL). This proposal would make changes to the DOL's 1979 regulation which explains how a fiduciary will satisfy his or her obligations under ERISA Section 404(a)(1)(B) with regard to an investment or an investment course of action. The proposal would also place new requirements on the use of environmental, social and corporate governance ("ESG") factors in investment decisions and on the use of ESG funds in participant-directed defined contribution plans.

While we offer some recommendations for changes and improvements in the regulation in this letter, we want to state at the outset that the Council strongly supports the importance of plan fiduciaries acting in accordance with ERISA's prudence and loyalty responsibilities when they make investment decisions. Our members believe that when they act as fiduciaries and make decisions regarding plan assets, they must act solely in the interest of participants and beneficiaries and with the exclusive purpose of providing benefits and defraying reasonable expenses. At the core of this proposal is an effort, which we support, to reiterate that a fiduciary must always make decisions in accordance with the "exclusive purpose" rule in ERISA Section 404(a)(1)(A).

1501 M Street NW Suite 600 Washington, DC 20005 202-289-6700 Facsimile 202-289-4582 www.americanbenefitscouncil.org

IMPORTANCE OF NOTICE AND COMMENT RULEMAKING

We support the DOL for tackling this issue of collateral goals in investment decisions through a formal rulemaking (although as we note later, we do recommend that the DOL proceed thoughtfully and deliberately). As you know, the DOL began addressing this and related issues shortly after the enactment of ERISA and has released subregulatory guidance, on and off, for decades.[1] In the initial years after passage of ERISA, the DOL addressed in letters and advisory opinions a variety of questions regarding the contours of permissible investment activities, such as multiemployer plans investing in subsidized mortgage loans to local communities with large union membership. In 1994 and 1995 the DOL issued two Interpretive Bulletins (IBs) that essentially took the position that investments that were associated with non-financial objectives were permissible provided that appropriate analysis was undertaken and that the investment would, absent the secondary considerations, be appropriate for the plan and involve no diminution of plan assets. In 1998 the DOL issued an advisory opinion to an investment firm that used socially screened funds, which concluded that such funds are not precluded by ERISA as long as "the investment was expected to provide an investment return commensurate to investments having similar risks." In 2005, 2007, and 2008, the DOL issued advisory opinions related to the use of plan assets in connection with public policy debates and then issued an IB in 2008 that revised the 1994 IB. Then again in 2015 the DOL issued an IB that purported to supplement the DOL's views. Most recently, in 2018, the DOL issued a Field Assistance Bulletin which was intended to "address questions" the DOL's national and regional offices may have regarding the IBs.

We recite this history to emphasize that, for the first time, the DOL is seeking public input on these important issues, and offering up a proposal for notice and comment. The Council strongly believes that notice and comment rulemaking is preferable and leads to a better outcome for participants, plan sponsors, the DOL and the regulated community. This is especially true here, where the issues covered by the proposal are long standing, do not involve the need for immediate guidance to address a new statutory rule or an emergency and will benefit from a thorough regulatory impact analysis.

The regulatory process allows for consideration of a variety of views and nuances in those views. Our letter itself reflects an attempt to reflect a number of voices of our membership. Council members who support parts of this regulation reached out to us to state that they support the priority of an ERISA fiduciary's focusing on pecuniary

[1] See, e.g., Interpretive Bulletin 94-1; Interpretive Bulletin 94-2; Advisory Opinion 98-04A; Interpretive Bulletin 2008-01; Interpretive Bulletin 2008-02, Interpretive Bulletin 2015-01; Interpretive Bulletin 2016-01; Field Assistance Bulletin 2018-01. For a list of DOL letters and advisory opinion predating Interpretive Bulletin 94-1, see those noted in footnotes 2 through 8 of the preamble to Interpretive Bulletin 94-1.

interest when selecting investments. Others expressed significant concern with the regulation.

As we have noted in the past, it is our view that the regulatory process is considerably enhanced by the discipline and additional consideration of costs and benefits that results from the requirements for economic impact analysis and formal OMB review under the Executive Orders that establish the requirements for Notice and Comment rulemaking for economically significant regulations. This route also imposes the discipline of other required standards (Regulatory Flexibility Analysis, Unfunded Mandates Reform Act, the Paperwork Reduction Act and various Executive Orders) that improves the quality and completeness of the policy deliberations. This is particularly important when considering regulations applicable to the voluntary employer-sponsored benefits system that will, as is the case for this regulation, potentially impose meaningful costs, entail complex consequences and affect the capacity of the system to provide benefits that are vital to the security and well-being of American workers.

The 1979 regulation has served as a flexible recitation of the investment duties of plan fiduciaries in a variety of investment situations and for a variety of investment goals. We believe that the regulatory process will ensure that only amendments to that regulation will be those justified by a thorough economic analysis and regulatory impact review. Well-reasoned and thoughtful regulations which reflect broad input from stakeholders also are more likely to stand the test of time, rather than being subject to shifts in the political winds.

In respect to this regulatory process, we offer two suggestions. First, we urge you not to rush to finalize the regulation until you have considered all points of view, including from those stakeholders with strong views on all sides of this issue, and collected sufficient information regarding the full array of costs and economic impacts to fully understand and consider these in the consideration of potential alternatives and the decisions embodied in the regulation. For example, given the very short comment period, we would urge the DOL to fully consider comments that come in after the deadline. Second, the regulation would impose a new requirement on qualified default investment alternatives (QDIAs). We believe that changes to the QDIA rules should not be made as part of an unrelated regulation; if any changes are needed to the requirements for a QDIA, they are better made as part of an amendment to the QDIA regulations.[2]

[2] For example, the QDIA regulation simply sets out the conditions that must be met for a default investment to qualify for the safe harbor treatment in ERISA Section 404(c)(5), namely that a participant who is defaulted into the investment is treated as having affirmatively elected the investment for purposes of ERISA Section 404(c). DOL has made clear that satisfying the QDIA regulation is not the exclusive means to satisfy fiduciary prudence in connection with plan investments. *See* Information Letter to Christopher Spence, TIAA (December 22, 2016). It is unclear if the proposed regulation is saying that use of ESG considerations in a QDIA will simply result in the loss of the protection of ERISA Section 404(c)(5), or will be considered a breach of fiduciary duty in the case of any default investment. If the latter, it is not clear why the proposed regulation references the QDIA rules at all.

CHANGES HAVE IMPACT FAR BEYOND ESG INVESTING

The preamble explains that the DOL proposed this regulatory amendment because "the growing emphasis on ESG investing may be prompting ERISA plan fiduciaries to make investment decisions for purposes distinct from providing benefits to participants and beneficiaries." And while the materials the DOL released in connection with the proposal (news release, fact sheets, etc.) are focused in large part on ESG investing, the proposal will have implications far beyond ESG investment mandates. We are concerned that this will have consequences the DOL did not intend.

The proposal would amend the 1979 regulation so that it covers not just the prudence requirement of ERISA Section 404(a)(1)(A) but also the exclusive purpose requirement of ERISA Section 404(a)(1)(B). In fact, Subsection (b)(1) of the proposal would provide that the prudence and exclusive purpose statutory rules *both* require the same set of obligations with respect to investment decisions, which would be listed in subsections (b)(1)(i) through (v) of the regulation. Thus, the prudence duty would apparently require that a fiduciary has not "acted to subordinate the interests of the participants and beneficiaries to the fiduciary's or another's interests and has otherwise complied with the duty of loyalty." And the exclusive purpose requirement would require that a fiduciary has "given appropriate consideration to those facts and circumstances that, given the scope of such fiduciary's investment duties, the fiduciary knows or should know are relevant to the particular investment or investment course of action involved." These two duties have never been understood to require the same actions by fiduciaries; rather it was assumed that Congress required both because they involve different duties and obligations.

Such an approach blurs the line between a prudent *process* for decision-making, which considers all the relevant facts and circumstances, with a mindset of unwavering loyalty to the purpose of providing benefits and defraying reasonable costs. We think this will lead to confusion in investment decision making, where none exists now.

We do not believe this entanglement of prudence and loyalty is solely a theoretical concern and we believe it may unintentionally impact investment decisions fiduciaries make each day, not just in selecting 401(k) plan menus but in managing defined benefit plan investments. Every investment decision now must be viewed not just as: "What facts and circumstances are appropriate to consider for a particular investment or investment course of action?" but also: "Is this a 'pecuniary factor' and can I prove that it will have a material impact on the risk or return of the investment?" To take a simple example: imagine a prudent investment review process focused solely on data regarding historical performance of different sectors of the economy, generates a recommendation to purchase companies involved in one industry with a low environmental impact. Even though the process was completely prudent as ERISA Section 404(a)(1)(B) requires, a fiduciary might feel compelled to reject the best

investment out of concern that a process that generates that investment recommendation violates the duty of loyalty. The better analysis is that duty of loyalty was satisfied because at no point in the process were collateral goals considered.

The reshuffling of the 1979 regulation may also generate confusion regarding longstanding understandings of the duty of loyalty and the related exclusive benefit rule. In that regard, we believe it would be helpful for the DOL to confirm its longstanding view, supported by Supreme Court decisions, that ERISA is not violated solely because a course of action has incidental benefits to the plan sponsor or other party-in-interest.[3]

There is another concern that our members have expressed about unintended consequences. As noted earlier, the proposal would impose a requirement for a fiduciary to document the analysis and rationale when choosing between "otherwise indistinguishable" alternatives considered using "generally accepted investment theories." The DOL states in the preamble that it believes this will apply only to a very narrow and rare set of circumstances in which two alternatives are found to be identical. We believe that the DOL has assumed a precision in the analysis of pecuniary factors that does not reflect how investment professionals operate. Projection of expected return, risk (variance of outcomes around a projected result) and future liquidity (capacity to sell at a known price) are all factors that are uncertain. In investment analysis, these factors are generally defined and evaluated within a projected range that includes some error term. This means that for practical purposes there are likely to be a very wide range of circumstances under which many alternatives are effectively deemed to be identical within generally accepted investment theories and analysis and which cannot be differentiated in a meaningful or material way. By stating otherwise in the preamble, the DOL seems to be suggesting something about the precision in how investment professionals evaluate investments that is not the case.

In reality, two investments' overall economic impact on a plan could be comparable/equal even if the investments' risk-return profile, fee structure, performance history and investment strategy are not each literally identical. Applying the tie breaker test to investment choices with the same overall economic impacts on a plan, within a reasonable range of expected outcomes, rather than only those that are identical in each and every respect (except for asset composition), would more appropriately reflect the process by which ERISA fiduciaries select plan investments.

To reiterate, we do believe it is important that fiduciaries act with the exclusive purpose of providing benefits and defraying reasonable costs. We also believe, as the regulation has always required, that a fiduciary should engage in a prudent process, documented where appropriate, that is reasonably designed to further the purposes of

[3] Advisory Opinion 2011-05A (Feb. 3, 2011) (citing Hughes Aircraft v. Jacobson, 525 U.S. 432 (1999) and Lockheed Corp. v Spink, 517 U.S. 882 (1996)).

the plan, taking into consideration the risk of loss and the opportunity for gain (or other return) associated with the investment or investment course of action. These bedrock principles are vital to the integrity of the private-employer pension system. ERISA's fiduciary standards safeguard the financial interests and well-being of employees and retirees by requiring those who are entrusted with the management and investment of plan assets to place the interests of plan participants above all other concerns. Our concern is that the regulation will inadvertently muddle these duties.

RISK OF INCREASED FRIVOLOUS LITIGATION

On July 7, 2020, the Council wrote to Secretary Scalia and Solicitor O'Scannlain to highlight a key issue that has, in recent years, created an unnecessary drain on the American economy: a damaging wave of complex class action lawsuits brought against American companies that offer their employees a 401(k)-style participant-directed defined contribution retirement plan and the service providers that support such plans. This baseless litigation is damaging the private retirement savings system and the American economy more generally.

This threat to the retirement savings system dwarfs many times over any risks posed by fiduciaries pursuing collateral goals in investment decisions, which in our experience is uncommon at best. For many of our member companies, the top issue in the retirement space is the proliferation of lawsuits and sources of potential liability.

As the DOL works towards a final regulation, we would urge you to consider what parts of the regulation might be exploited by baseless class action lawsuits. Once the plaintiffs' bar develops and refines a framework for class action claims in the ERISA space, they often will begin filing similar claims against non-ERISA plan sponsors, IRA providers, and other investment advisers, with even broader economic impact. Considering any such impact is critical to the economic analysis the DOL must perform.

For example, Subsection (b)(2)(ii)(D) of the proposal would add to the description of "appropriate consideration" a requirement that the fiduciary consider "[h]ow the investment or investment course of action compares to available alternative investments or investment courses of action." While we do not fundamentally disagree that one investment decision necessarily entails forgoing another investment decision, we are concerned this requirement, which is imposed *on top of* the requirement to consider all relevant facts and circumstances, may be exploited by class action firms. After all, there are always thousands of alternative investments available and a class-action firm need only identify one that outperformed the investment chosen to make a claim to try to survive a motion to dismiss and reach discovery.

We recommend deletion of paragraph (b)(2)(ii)(D), the requirement to compare a contemplated investment or investment course of action with "available alternative[s]"

in order to show that "appropriate consideration" was given to the investment or investment course of action. Our recommendation is based primarily on the observation that the requirement is too broad. ERISA's doctrine of prudence already implies that reasonable consideration be given to alternative investments or investment courses of action. Ultimately, investments cannot be evaluated in a vacuum, only through relative assessment. But an explicit comparison requirement could be construed to include a comprehensive and continuous evaluation of all investment alternatives, which would be neither practical nor feasible.

We know that the DOL does not intend to introduce uncertainty and risk of frivolous litigation and we share the goal of reducing confusion. We raise the risk of baseless litigation to help the DOL focus on those changes to the regulation that are truly needed to, as the DOL describes it, "provide clarity and certainty."

LACK OF CLARITY REGARDING ESG DEFINITIONS

To further illustrate our fear of the unintended broad sweep of the regulation, we focus now on the parts of the regulation that apply when "economic, social, corporate governance, or other similarly oriented" considerations are involved. This arises twice in the regulation. First Subsection (c)(1) states that such factors "are pecuniary factors only if they present economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories." It then states: "Fiduciaries considering environmental, social, corporate governance, or other similarly oriented factors as pecuniary factors are also required to examine the level of diversification, degree of liquidity, and the potential risk-return in comparison with other available alternative investments that would play a similar role in their plans' portfolios."

In addition, Subsection (c)(3) of the proposed regulation states that, in the case of a participant-directed defined contribution plan, if a fiduciary adds investments "that include one or more environmental, social, corporate governance, or similarly oriented assessments or judgments in their investment mandates, or that include these parameters in the fund name," the fiduciary (a) must use only objective risk-return criteria for selecting and monitoring the fund; (b) must document that its selection and monitoring was so focused; and (c) may not make such an investment the plan's QDIA.

The first concern with these provisions is that they may have the effect of impacting investment decisions totally unrelated to ESG considerations, because the regulation requires a fiduciary to determine if they apply in the first instance. That is, even if a fiduciary is acting with a sole focus on providing benefits and defraying reasonable expenses, if an investment manager or investment fund will be taking into account "environmental, social, corporate governance, or similarly oriented assessments or judgments" then the fiduciary overseeing the manager or fund may need to take certain

additional steps. And that can mean constant, unnecessary and burdensome monitoring on the part of the fiduciary. It could also mean that a fiduciary feels compelled to remove an otherwise well-performing fund because of concerns about the enhanced requirements.

The second concern is that the regulation does not *define* “environmental, social, corporate governance, or similarly oriented assessments or judgments.” We think the intention is that these factors are intended to be non-pecuniary in nature. But environmental, social, corporate governance, or similarly oriented assessments or judgments are neither a necessary nor a sufficient condition for a non-pecuniary factor.

The existence of ESG factors is not a sufficient condition for a non-pecuniary factor because many ESG factors are pecuniary in nature. Evaluating long-term risks, including ESG risks that have a material impact on the risk or return of an investment, is fundamental to investing. The DOL itself points out some examples of ESG factors that would be critical to consider. The DOL notes that “a company’s improper disposal of hazardous waste would likely implicate business risks and opportunities, litigation exposure, and regulatory obligations.” The DOL also notes that “[d]ysfunctional corporate governance can likewise present pecuniary risk that a qualified investment professional would appropriately consider on a fact-specific basis.” But the text of the proposal appears to suggest that almost all ESG factors are non-pecuniary in nature. In contrast we believe it is difficult for plan fiduciaries to avoid consideration of any corporate governance factor. We think it is common practice for prudent fiduciaries to look at corporate governance practices when evaluating a company’s long-term investment prospects. But subsections (c)(3)(i), (ii) and (iii) apply to *any* designated investment alternative that “include[s] one or more environmental, social, corporate governance, or similarly oriented assessments or judgments in their investment mandates.” That means fiduciaries may decide that they need not only to constantly monitor for what might be ESG decisions by the plan’s investment managers, but also do so without clear guidance on what would constitute an ESG factor covered by those sections.

Enshrining a specific terminology to describe the non-pecuniary factors that are prohibited or constrained by ERISA’s duty of loyalty seems to us to be inappropriate. The proposed regulation oversimplifies the considerations that an investment professional would take into consideration in evaluating an investment’s ability to contribute excess risk-adjusted returns. Accordingly, we do not see a justification for singling out ESG factors.

Even some of our members who do not use ESG-themed investments told us that the documentation requirement of paragraph (c)(3)(ii) is broad and unnecessary. The breadth of the requirement is a recipe for either a misallocation of resources (fiduciaries will spend more time than is really necessary to compile contemporaneous documentation relating to their selection of investment options) or unnecessary and

unwanted liability (e.g., from a plaintiffs' bar pursuing theories of liability simply for failure to maintain adequate documentation). Either result is unnecessary and wasteful. A fiduciary should not be held liable if it can show that it made an appropriate investment decision even if it did not document the decision at the time.

THE ECONOMIC IMPACT ANALYSIS IS NOT COMPLETE

As noted earlier, it is very important for a regulation of this nature and consequence to be formulated on the basis of a complete analysis and discussion of the full range of potential costs and economic impacts. This remains one of the prime motivations and requirements behind the Executive Orders and OMB standards governing significant regulatory proposals. It is our view that the spirit and promise of these requirements fall short in the current proposal and that the proposal will require further data collection, analysis and elucidation of these issues to meet the objectives and standards of the Administrative Procedures Act and various Executive Orders that are cited in the proposal.

At a very basic level two procedural points are of concern. First, the language of the proposal addressing economic impacts asserts that the regulation is economically significant because it will have an impact on the economy of more than $100 million per year and/or includes novel policy issues. There is however no further explanation of how this conclusion is reached and the cost analysis appears to indicate that there are no material costs, which seems to be an inherent contradiction. If the DOL has concluded that this is a major regulation, the analysis through which this conclusion is reached should be made clear and the supporting economic impact analysis indicating how it exceeds the $100 million threshold presented. If the conclusion is solely based on novel issues there would seem to be an internal inconsistency with a regulation that ostensibly asserts that it is simply a reiteration of existing policy. If, however, this is the rationale, the DOL should indicate how the conclusion was reached that there is an impact above the $100 million threshold. Second, the regulation asserts that it is subject to the Executive Order 13711 that requires the withdrawal of two regulations for each new regulation. It would be very helpful to understanding what regulations are to be withdrawn to fulfill the requirements of this EO.

More importantly, the economic impact analysis presented is incomplete in several ways. It is predicated on the idea that the circumstances that would trigger the additional documentation requirements are rare or nonexistent. Some would reasonably disagree and to truly assess the likely economic impact and costs DOL will need to far more carefully and rigorously explore how investment decisions are actually made and the likely incidence of circumstances in which choices are made among otherwise economically indistinguishable alternatives. A regulation of this nature ideally should be preceded by a formal Request For Information that provides insights

and information from plan fiduciaries, investment practitioners and others on this issue to inform DOL's decision making and impact analysis.

In addition to the direct cost issues that are not fully addressed (which may include additional analysis, record keeping, and litigation costs) the economic impact analysis does not address or consider a number of potentially important indirect (or behavioral) consequences of the regulation. Because the regulation would be likely to impose additional costs and risk for a plan sponsor to provide an ESG themed choice in a participant-directed plan, the impact analysis should consider whether plan sponsors can be expected to eliminate this option or restructure their investment line-up to include a much larger array of options in order to ensure that any potential risks are effectively managed and the full consequences of this result. Consideration should be given in the analysis to the potential impact on a number of critical issues including plan participation rates, the level of elective deferrals and the alignment of investment patterns with the objective of maximizing retirement income within the risk preferences of individuals with widely varying characteristics.

As is noted in the preamble to the proposal, it may be the case that some individuals may seek to direct their savings into ESG products for non-financial motives. This suggests that some would potentially reduce their contributions to employer plans in lieu of other available alternatives, despite the fact that savings outside of a tax-favored employer plan may not offer the same level of financial outcomes. There is behavioral research that can inform this impact analysis that needs to be considered as well as plan sponsor experience with changes when such an option is introduced or removed. The DOL should seek to assess how plan sponsors may react to such a rule and review the relevant behavioral research to reach a conclusion about what is likely to occur within employer plans before implicitly concluding that there are no indirect economic impacts from the proposal, some of which may be deleterious to the capacity of the employer sponsored system to deliver benefits.

IMPLEMENTATION CONCERNS

The Council's plan sponsor members have a variety of views about offering ESG funds in their 401(k) plans. We believe flexibility, so long as consistent with ERISA's prudence and loyalty rules, should be the North Star.[4] For those employers that have or wish to offer ESG-themed funds to participants or to take them in account as tie-breakers, we believe it is critical that there be a path forward for those plan sponsors.

[4] Some plan sponsors have employees and operations in multiple countries, which may take a variety of views on ESG investments. Some countries require corporations adopt corporate ESG policies. While we are not suggesting that multinational companies need not comply with ERISA with respect to its U.S. plans, we believe that flexibility is need to reflect the complexities of multiple jurisdictions.

First, we believe it should be sufficient to reiterate the point that it is sufficient that ERISA already requires that any fund, including an ESG fund, is "prudently selected, well managed, and properly diversified."

Second, to the extent that the DOL will retain in the final rule additional burdens on plan fiduciaries when considering ESG funds, it is critical that *workable* guidance is provided as to which funds must be subjected to the additional work required by the plan fiduciaries and which will not. It cannot simply be that the investment manager considers some environmental, social, or governance factor, because that factor might be a normal pecuniary factor. Unless it is obvious from the title of the fund, or the investment manager otherwise discloses that the investment will take into account non-pecuniary considerations that are *not* expected to have a material impact on risk or return, the plan fiduciary cannot know for certain if the additional requirements of the regulation must be met.

* * * *

We end where we started, by supporting the DOL's goal to provide clarity and certainty. To do so through a regulatory project that allows for public input and requires the DOL to demonstrate that the proposal is needed and will have positive economic benefits for plans and participants. We offer the comments above to highlight areas of unintended consequences and the need for certainty in implementation.

Sincerely,

Jan Jacobson
Senior Counsel, Retirement Policy