United States Senate
WASHINGTON, DC 20510

December 10, 2021

The Honorable Martin J. Walsh
Secretary
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, D.C. 20210

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

Dear Secretary Walsh:

We are concerned by the Department of Labor's (DOL) October 14, 2021 proposal that purports to dismantle two important actions taken by DOL last year that protect the retirement savings of millions of American workers.[1] Those actions, which amended the Investment Duties regulation under the Employee Retirement Income Security Act of 1974 (ERISA), collectively prohibit the fiduciaries of private-sector retirement plans from making investment decisions and exercising shareholder rights in a manner that subordinates the financial interests of workers and retirees to non-pecuniary interests, such as global warming and other environmental, social, and governance (ESG) factors. They are based on the common-sense, unobjectionable principle that fiduciaries of retirement plans must put the financial interests of plan participants and beneficiaries first.

DOL claims that the proposal will simply "remove barriers to plan fiduciaries' ability to consider climate change and other environmental, social and governance factors when they select investments and exercise shareholder rights."[2] However, in reality, the proposal effectively mandates consideration of climate change and ESG factors in all investment and proxy voting decisions. In addition, the proposal vastly expands the circumstances in which retirement plan fiduciaries can pursue "woke" ESG causes even when they provide no financial benefits to plan participants and beneficiaries. As a result, it will significantly harm Americans' retirement savings by allowing plan fiduciaries to promote non-pecuniary policy objectives like lowering global carbon emissions and promoting "social justice" rather than being solely focused on maximizing investment returns.

DOL's proposal is deeply flawed for multiple reasons. It fails to define what ESG considerations or factors are, or explain why such terminology is an appropriate regulatory standard. It imposes a *de facto* mandate on fiduciaries of retirement plans, requiring them to consider ESG factors that are not supported by DOL's own regulatory impact analysis (RIA), and the steps needed to comply with the obligation are unclear and ambiguous. Even though DOL's press materials suggest otherwise, the proposal does not appear to significantly change any legal liability from

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[1] Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 FR 57272 (Oct. 14, 2021).
[2] U.S. Department of Labor, Press Release No. 21-1847-NAT (Oct. 13, 2021), available at https://www.dol.gov/newsroom/releases/ebsa/ebsa20211013.

private class actions under ERISA and, as a result, plan fiduciaries who select ESG investments may be subject to increased litigation risk should those investments result in higher fees, inferior risk-adjusted performance, and/or less diversification.

Given the wide divergence of views within the investment community as to whether ESG investing outperforms conventional investing, the need for clear guidance to ERISA plan fiduciaries is of great importance. The proposal, by reminding plan fiduciaries of their potential liability under ERISA, but remaining ambiguous as to whether and when it is appropriate to incorporate ESG factors, or indeed when ESG investing is to be a mandatory investment strategy, fails immeasurably on that score.

Recent analyses have disputed the notion that ESG funds have outperformed the wider market, with reputable investors dismissing the incorporation of such non-pecuniary factors as social justice and climate change as "a ruse to launder reputations, maximize fees, and assuage guilt."[3] Earlier this year, a former chief investment officer for sustainable investing at BlackRock warned investors against exploiting environmental factors in investing. He noted that "claiming to be environmentally responsible is profitable" for Wall Street asset managers, but advancing "real change in the environment simply doesn't yield the same return."[4]

In light of the inchoate nature of ESG investing, clearly delineating how and when it is appropriate for retirement plan fiduciaries to incorporate ESG factors is of heightened necessity. DOL's proposal fails to clearly explain when ESG is an appropriate exercise of the duty of prudent management, and fails to articulate sufficient, non-arbitrary factors justifying the amendment of rule provisions it enacted just last year after an open and transparent notice and comment rulemaking process.

I. *The proposal fails to define what ESG means or explain DOL's reversal of its position that ESG terminology is not an appropriate regulatory standard*

DOL's proposal is fatally flawed because it does not define the scope of ESG considerations or factors, terms which are used throughout the proposal. Understanding the considerations or factors that fall within the scope of these terms is important because the proposal states that plan fiduciaries "may often" be required to consider them. Without these definitions, fiduciaries will have little idea whether the ESG factors they decide to consider comply with the DOL rule and protect them against legal action.

Moreover, the proposal fails to explain DOL's change in position from November 2020, when DOL stated that it "was persuaded by its review of the public comments that 'ESG' terminology, although used in common parlance when discussing investments and investment strategies, is not

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[3] See, e.g., Steve Johnson, *ESG Outperformance Narrative "Is Flawed," New Research Shows*, Financial Times (May 3, 2021), available at https://www.ft.com/content/be140b1b-2249-4dd9-859c-3f8f12ce6036 (quoting Sony Kapoor, Nordic Institute for Finance, Technology, and Sustainability).

[4] Tariq Fancy, *Financial World Greenwashing the Public with Deadly Distraction in Sustainable Investing Practices*, USA Today (Mar. 16, 2021), available at https://www.usatoday.com/story/opinion/2021/03/16/wall-street-esg-sustainable-investing-greenwashing-column/6948923002/.

a clear or helpful lexicon for a regulatory standard."[5] DOL agreed that ESG terminology suffers from "two distinct shortcomings as a regulatory standard."[6] First, DOL concluded that ESG terms do not have a uniform meaning, the terminology is evolving, and the goals being advocated today may not be the same as those in the future. Second, DOL stated that by conflating unrelated factors into a single term, ESG, invites a less than appropriately rigorous analytical approach in evaluating whether "any given E, S, or G factor" presents a material business risk or opportunity.

Given the important role that ESG factors play in understanding the proposal, the use of such terminology in the proposal is arbitrary and capricious under the Administrative Procedure Act.[7] DOL failed to provide any reasoned analysis for its change in position that ESG terminology is not a clear or helpful lexicon for a regulatory standard.[8] The proposal lacks any awareness that DOL is departing from its prior position on ESG terminology as a regulatory standard and results in an unexplained inconsistency.[9]

II. The proposal's "appropriate consideration" provision will in practice be viewed as a mandate by retirement plan fiduciaries to consider ESG factors, irrespective of financial materiality, and such an outcome is not supported by the regulatory impact analysis

DOL's proposal would define "appropriate consideration" of an investment under ERISA to include, among other things, consideration of the projected return of an investment relative to the funding objectives of a retirement plan, "which may often require an evaluation of the economic effects of climate change and other environmental, social, or governance factors" on the investment. This "may often" language will likely be viewed as a mandate by fiduciaries to consider climate change and other ESG factors out of concern of being second-guessed retroactively.[10] However, the proposal and its RIA contain no support for the requirement that climate change and other ESG factors "may often" need to be considered.

The proposal does not provide a rational basis for the contention that climate change and other ESG factors are often material or that they are not already priced into the market. If these impacts are already priced into the market, then further consideration of climate change and other ESG factors would not result in investment gains. The RIA further undercuts support for

[5] Financial Factors in Selecting Plan Investments, 85 FR 72846, 72857 (Nov. 13, 2020).
[6] Id.
[7] 5 U.S.C. Sec. 500 et seq.
[8] See, e.g., Motor Vehicles Mfrs. Ass'n v. State Farm Ins., 463 U.S. 29 (1983) (requiring an agency to provide a reasoned analysis).
[9] See FCC v. Fox Television Stations, 556 U.S. 502, 515 (2009) ("the requirement that an agency provide reasoned explanation for its action would ordinarily demand that it displays awareness that it *is* changing position"); see also Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 981 (2005) (finding that agency inconsistency is a reason for holding an interpretation to be arbitrary and capricious under the Administrative Procedure Act).
[10] For example, with respect to proxy voting, although DOL has never taken the position that a plan fiduciary must vote every proxy, DOL recognized a "misplaced belief" that fiduciaries must "always and in every case vote proxies, subject to limited exceptions" under ERISA. See Fiduciary Duties Regarding Proxy Voting and Shareholder Rights, 85 FR 81658, 81659 (Dec. 16, 2020).

DOL's contention that these factors may often be material to financial performance, as it observes that the "literature overall has varied findings" as to whether ESG investing has financial benefits, that "there are many studies with mixed or inconclusive results," and that "other studies have found that ESG investing has resulted in lower returns than conventional investing."[11]

Given this RIA discussion, we are alarmed that DOL requests comment on whether ERISA fiduciaries should consider climate change as presumptively material in their assessment of investment risks and returns.[12] In light of DOL's prior position that considering ESG factors as a mandatory investment strategy is "inconsistent with the [DOL's] considered view and sound policy,"[13] any such presumption would be arbitrary and capricious. Moreover, DOL has never adopted a rule that particular investment factors must be considered as part of the fiduciary duties under ERISA. Doing so now invites the creation of a regulatory "laundry list" for the selection of investments for ERISA plans.

Neither the proposal's RIA nor its preamble considers that ESG-oriented investments often carry higher fees and expenses than comparable non-ESG investments.[14] The failure to address such concerns in the proposal implies that it is appropriate to select an investment with higher expenses without demonstrating a commensurate improvement in risk-return. This approach contradicts prior DOL concerns about unnecessary expenses negatively affecting retirement savings.[15]

III. The proposal's provision on "appropriate consideration" of climate change and other ESG factors is unclear and ambiguous and may require plan fiduciaries to invest in fossil fuel-related assets if such assets have higher expected returns

The proposal's provision that climate change and other ESG factors "may often" be required to be considered is unclear and ambiguous. Indeed, the proposal may accomplish the opposite of the Biden administration's preferred outcome on climate change, because the rule may be viewed as mandating investment in fossil fuel-related assets, like oil, gas, and coal, particularly if non-ERISA investors materially increase the costs of capital for these companies.[16]

Increases in costs of capital to fossil fuel-related assets may result in higher risk-adjusted returns and the failure of a plan fiduciary to invest in such assets could be a breach of fiduciary duty. This could occur if investor sentiment for so-called clean energy assets causes fossil fuel-related

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[11] 86 FR at 57290-91.
[12] Id. at 57290.
[13] 85 FR at 72858.
[14] See, e.g., Michael Wursthorn, *Tidal Wave of ESG Funds Brings Profit to Wall Street*, Wall Street Journal (Mar. 16, 2021).
[15] See Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 FR 20946, 20950 (Apr. 8, 2016) (discussing how biased advice can inflict losses on investors by choosing "more expensive and/or poorer performing investments); see also Council of Economic Advisers, *The Effects of Conflicted Investment Advice on Retirement Savings* (2015), available at https://obamawhitehouse.archives.gov/sites/default/files/docs/cea_coi_report_final.pdf.
[16] See Alon Brav and J.B. Heaton, *Brown Assets for the Prudent Investor*, Harvard Business Law Review Online (Fall 2021) (forthcoming), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3895887.

assets to be underpriced, thereby generating higher expected returns. Fossil fuel-related assets may provide a valuable hedge against the costs of climate change should there be a failure to transition to a low-carbon economy.[17] Thus, ERISA fiduciaries with obligations to exercise prudence in selecting investments, including the duty to diversify, may be subject to liability from private rights of action under ERISA for failing to invest in fossil fuel-related assets under the proposal.

IV. Contrary to DOL's press materials, the proposal may not significantly change any legal liability from private class actions under ERISA as described by the existing rule issued by DOL in 2020

Far from clarifying DOL's existing rule, the proposal creates unnecessary traps for plan fiduciaries in private class actions under ERISA. In the preamble to the existing rule, DOL "fundamentally accepted" that "ESG considerations may present issues of material risk or opportunities to companies that company officers and directors need to manage as part of the company's business plan and that qualified investment professionals would treat as economic considerations under generally accepted investment theories."[18] Declaring that a plan fiduciary may consider any factor that is material to the risk-return analysis, the proposed rule text appears to restate DOL's position set forth during the Trump administration.[19]

Thus, the proposal may not significantly change any legal requirement or liability with respect to ERISA fiduciary duties on ESG factors as described by the Trump administration. To the extent that plan fiduciaries believe they now have a "green light" to make ESG investments that were not previously prudent under the existing rule adopted by the Trump administration, nothing in the proposal appears to change their liability.

Similarly, the proposal repeats the current rule adopted by the Trump administration that ERISA fiduciaries cannot sacrifice return or increase risk for the purpose of promoting collateral goals unrelated to the economic interest of plan participants.[20] Any use of ESG factors must be solely in furtherance of financial benefits for ERISA participants. DOL cannot, by rule, change the U.S. Supreme Court's holding from *Fifth Third Bancorp vs. Dudenhoeffer*,[21] which held that "benefits" for plan participants and their beneficiaries under ERISA must be understood to refer to "financial benefits."

To the extent that ERISA fiduciaries select investments pursuing collateral ESG objectives, they will open themselves to liability in private rights of action for breach of their fiduciary duties, including the duty of prudence. Plan fiduciaries selecting ESG strategies should be particularly cautious of investments with higher fees as well as risk factors or disclosures suggesting that climate change or ESG considerations may result in lower returns, higher volatility, reduced diversification, and forgoing potentially profitable investment opportunities.

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[17] See id.
[18] 85 FR at 72857.
[19] See proposed rule 404a-1(b)(4), 86 FR at 57302.
[20] See proposed rule 404a-1(c), 86 FR at 57303.
[21] 573 U.S. 409 (2014).

Furthermore, the elimination of recordkeeping requirements for ESG investments will provide a false sense of security to plan fiduciaries, as they will still need to demonstrate how they satisfied their fiduciary duties under ERISA in any private rights of action should such ESG investments result in lower investment returns when compared to non-ESG investments.

For the reasons set forth above, we urge DOL to withdraw the proposal.

Sincerely,

Pat Toomey
Ranking Member
U.S. Senate
Committee on Banking, Housing, and Urban Affairs

Mike Crapo
Ranking Member
U.S. Senate
Committee on Finance

Richard Burr
Ranking Member
U.S. Senate
Committee on Health, Education, Labor and Pensions

Tim Scott
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