AMERICAN RETIREMENT ASSOCIATION

4401 N. Fairfax Drive | Suite 600 | Arlington, VA 22203
P 703.516.9300 | F 703.516.9308 | info@usaretirement.org | usaretirement.org

Working for America's Retirement

July 30, 2020

Office of Regulations and Interpretations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Ave, NW, Ste. 400
Washington DC 20210
via Federal eRulemaking Portal at www.regulations.gov

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

Dear Department of Labor,

The American Retirement Association (ARA) appreciates the opportunity to provide our views on the Department of Labor's (DOL's) proposed rule concerning Financial Factors in Selecting Plan Investments–RIN: 1210–AB95 (the Proposal). As explained in further detail below:

- **The ARA does not believe that DOL guidance should discourage ERISA fiduciaries from considering environmental, social, governance (ESG) factors as they evaluate plan investment options; and**
- **The ARA believes otherwise-appropriate investments that include ESG factors should not be prohibited from qualifying as Qualified Default Investment Alternatives (QDIAs) or as a component of a QDIA.**

The ARA is the coordinating entity for its five underlying affiliate organizations representing the full spectrum of America's private retirement system, the American Society of Pension Professionals and Actuaries (ASPPA), the National Association of Plan Advisors (NAPA), the National Tax-Deferred Savings Association (NTSA), the American Society of Enrolled Actuaries (ASEA), and the Plan Sponsor Council of America (PSCA). ARA's members include organizations of all sizes and industries across the nation who sponsor and/or support retirement saving plans and are dedicated to expanding on the success of employer sponsored plans. In addition, ARA has nearly 30,000 individual members who provide consulting and administrative services to the sponsors of retirement plans. ARA and its underlying affiliate organizations are diverse but united in their common dedication to the success of America's private retirement system.

The ARA shares the DOL's objective of safeguarding the interests of participants and beneficiaries in retirement savings plans. The ARA and its underlying affiliate organizations have long been supportive of the principle that informs the Proposal: participants and beneficiaries are best served when plan fiduciaries understand the application of ERISA's principles to selection of plan investments. ERISA

4401 N. Fairfax Drive | Suite 600 | Arlington, VA 22203
P 703.516.9300 | F 703.516.9308 | info@usaretirement.org | usaretirement.org

fiduciaries' obligations of prudence and exclusive purpose are at the heart of ERISA's protections of plans and participants.

The ARA believes that ERISA requirements for fiduciaries selecting plan investments should neither promote the sacrifice of investment returns or assumption of greater investment risks as a means of promoting collateral social policy goals, nor should they preclude consideration of benefits other than investment return. While ostensibly crafted to clarify the Department's long-standing perspective, the Proposal instead opens the door to complex interpretations of how to regard ESG factors. This ultimately could stifle investment selection, decrease participant savings rates and diminish portfolio diversification. The ARA shares the DOL's goal of safeguarding the interests of participants and beneficiaries, but we believe those interests are best served by providing plan fiduciaries as a matter of prudence the opportunity to consider the impact that factors such as ESG could serve – or impede – long-term performance. With that in mind, we appreciate the opportunity to provide these comments.

Background

The Proposal amends ERISA's "Investment Duties" regulation[1], which was intended as a safe harbor such that "fiduciaries who comply with the provisions of the regulation will have satisfied the requirements of the 'prudence' rule…."[2] Under the regulation, the prudence requirement of ERISA section 404(a)(1)(B) is satisfied if (1) the fiduciary making an investment or engaging in an investment course of action has given appropriate consideration to those facts and circumstances that, given the scope of the fiduciary's investment duties, the fiduciary knows or should know are relevant, and (2) the fiduciary acts accordingly.

Since the Investment Duties regulation was first promulgated in 1979, the DOL has periodically considered the application of ERISA section 404 principles to plan investments selected, in part, because of non-pecuniary benefits they may further, such as those relating to ESG considerations.[3] Standards relating to investments that include ESG or other similarly-oriented considerations, have been the subject of several iterations of subregulatory guidance during this time. It is widely-recognized that during this same period, interest surrounding investments promising the furtherance of various ESG objectives has grown.[4] Indeed, ESG investing appeals to investors across all age groups, according to new research from Morningstar. The investment research firm found that a majority of the U.S. population — 72% — is interested in investing in ESG funds.[5] Moreover, a growing number of active management funds are recognizing the materiality of ESG factors in evaluating investments; by inference, this effects the passive investing world that tracks those. Further, one of the largest investment managers for individual account plans (by assets), has announced the full integration of ESG principles into the normal qualitative

[1] 29 C.F.R. section 2550-404a-1.
[2] 44 Fed. Reg. 37221, 37222 (June 26, 1979).
[3] 85 Fed. Reg. 39113, 39114 (June 30, 2020).
[4] *Id.*
[5] https://www.morningstar.com/content/dam/marketing/shared/pdfs/InvestorSuccessProject/esg-investor/esg-investor.pdf?utm_source=eloqua&utm_medium=email&utm_campaign=&utm_content=16943

investment selection process for their entire suite of "active" investment products, on the theory that these criteria are meaningful to the long-term performance and risk of the underlying companies.[6]

Discussion

The analytical premise of DOL's guidance over the years regarding fiduciary investment duties has been fundamentally consistent; it has provided that ERISA fiduciaries may not sacrifice financial returns in pursuit of "collateral" non-financial benefits. That is, maximization of investment returns must be prioritized above all else when making investment decisions for ERISA plans. The guidance generally has allowed, to varying degrees, for non-economic elements of an investment to be considered if (a) the investment has an expected rate of return commensurate with rates of return of available alternative investments with similar risk characteristics and (b) the investment is otherwise an appropriate investment for the plan.

In a departure from this foundation, the Proposal would largely, if not nearly completely, constrain a fiduciary from considering ESG factors as part of a prudent process even those deemed to have a substantive impact on long-term investment returns. More specifically, in removing the "all things equal" standard, the Proposal allows the fiduciary to select an ESG fund only if doing so does not mean the plan gives up other non-ESG investment options and the fiduciary uses only "objective" risk and return criteria to select investments.

At the same time, the preamble points out that there is not a uniform definition of "ESG" or what constitutes an investment product or process that is based upon factors related to ESG considerations. Similarly, the preamble adds, "[a]s ESG investing has increased, it has engendered…inconsistencies, with numerous observers identifying a lack of precision and rigor in the ESG marketplace" and "there is no consensus about what constitutes a genuine ESG investment, and ESG rating systems are often vague and inconsistent…".[7] Considering this lack of consensus, the ARA is concerned that even the most prudent investment option could be excluded by a plan simply because of an ESG label in marketing materials or because ESG factors are invoked in an investment disclosure. Alternately, without clarity on the definition of what "ESG factors" are, plan sponsors may be challenged to ensure they are meeting the Proposal's additional diligence and documentation requirements. Moreover, they might feel pressed to overlook such an option, even if it were deemed to be prudent and a superior investment choice simply because ESG is incorporated in its construction and maintenance.

- **The ARA does not believe that DOL guidance should discourage ERISA fiduciaries from considering environmental, social, governance (ESG) factors as they evaluate plan investment options.**

The ARA does not believe that DOL guidance should promote nor prohibit a fiduciary from considering an otherwise prudent investment simply because it includes ESG factors. To the contrary, the ARA believes ESG factors are worthwhile and important elements of a prudent investment

[6] *See* "ESG Integration," *at* https://www.blackrock.com/institutions/en-zz/solutions/sustainable-investing/esg-integration
[7] 85 Fed. Reg. at 39115.

AMERICAN RETIREMENT ASSOCIATION

4401 N. Fairfax Drive | Suite 600 | Arlington, VA 22203
P 703.516.9300 | F 703.516.9308 | info@usaretirement.org | usaretirement.org

Working for America's Retirement

selection process. We are far from alone in this belief. Throughout financial markets worldwide, an appropriate corporate governance policy is recognized as beneficial. For example, the Preamble to the OECD Principles of Corporate Governance asserts that the degree to which corporations observe basic principles of good corporate governance is an increasingly important factor for investment decisions.[8] Competent investment managers now place good corporate governance among requisite features that support investment value. The ARA recognizes that to do otherwise would be contrary to prudent investment management.

DOL's concerns regarding the role of ESG factors in fiduciary decision-making appears in part related to marketplace trends. In the Proposal's preamble, DOL says, "[r]ecently, there has been an increased emphasis in the marketplace on investments and investment courses of action that further non-pecuniary objectives, particularly what have been termed environmental, social, and corporate governance (ESG) investing." At the same time, DOL acknowledges that ESG factors can be pecuniary factors…if they present economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories."[9] Regardless, the DOL's foundational concern seems to be a "growing emphasis on ESG investing [which] may be prompting ERISA plan fiduciaries to make investment decisions for purposes distinct from providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plan."

If the DOL believes that marketplace factors may inappropriately "prompt" ERISA fiduciaries' evaluation of plan investments, the appropriate remediation lies with the marketplace information that ERISA fiduciaries receive. That is, the issue that DOL discerns may not arise through the processes by which ERISA fiduciaries evaluate potential plan investments, rather it may originate in the representation of ESG factors in investment products and financial risk analysis. Ultimately, regulators of investment marketing and related standards, not the DOL, may be better positioned to address disclosures and marketing of ESG investments. The Securities and Exchange Commission (SEC), as an example, has been reviewing disclosures from ESG funds to ensure that their marketing accurately reflects their investing strategies.[10] An SEC Commissioner remarked that fund groups need to improve disclosure standards for sustainable investment products."[11]

---

[8] Policy Framework for Investment User's Toolkit, Chapter 6. Corporate Governance, *at* http://www.oecd.org/investment/toolkit/policyareas/corporategovernance/44931152.pdf

[9] EBSA News Release, "U.S. Department of Labor Proposes New Investment Duties Rule, *at* https://www.dol.gov/newsroom/releases/ebsa/ebsa20200623.

[10] https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-of-the-investor-as-owner-subcommittee-on-esg-disclosure.pdf.

[11] "SEC commissioner calls for better ESG labelling" *at* https://www.ft.com/content/ed4452e6-cd04-49d6-b2b7-6e098dc715a4 (July 12, 2020).

Investment Duties

It is well-established that an ERISA fiduciary may not subordinate participants' or beneficiaries' interests to the fiduciary's interest while the fiduciary is acting in a fiduciary capacity. ARA members have long applied ERISA's fiduciary principles in carrying out their fiduciary duties when selecting plan investments and investing plan assets, regardless of the type of investment. We support this principle and believe that the Proposal's broad language sufficiently encompasses these important principles.

The Proposal requires a fiduciary to evaluate "investments and investment courses of action based solely on pecuniary factors that have a material effect on the return and risk of an investment." *Proposed 29 CFR sec. 2550-404a-1(b)(1)(ii).* The Proposal also requires that a fiduciary not subordinate the interests of participants and beneficiaries in their retirement income or financial benefits under the plan to unrelated objectives, or sacrifice investment return or taken on additional investment risk to promote goals unrelated to those financial interests of the plan's participants and beneficiaries or the purposes of the plan." *Proposed 29 CFR sec. 2550-404a-1(b)(1)(iii).* It further requires that a fiduciary "has not otherwise acted to subordinate the interests of the participants and beneficiaries to the fiduciary's or another's interests." *Proposed 29 CFR sec. 2550-404a-1(b)(1)(iv).*

ARA believes that this foundational language may be simplified. Subparagraph (iv) is sufficiently comprehensive to encompass the exclusive purpose requirement, implicitly protecting participants and beneficiaries, making subparagraph (iii) superfluous and potentially confusing.

Investment Alternatives for Individual Account Plans

The Proposal applies to fiduciaries' selection of designated investment alternatives for individual account plans and imposes additional standards and documentation requirements for plans that allow participants to choose from a broad range of investment alternatives if an ESG or similar option is considered.

Additional Standards for Plans with Any ESG or ESG Component Investing—Proposed 29 CFR sec. 2550-404a-1(c)(3)

If there is any alternative investment in an ERISA section 404(c) plan's lineup that invests in "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 Proposal would require plan fiduciaries to apply a heightened standard and document the selection of investments in the plan's lineup.

The scope of these additional requirements needs to be clarified but may also simply be impracticable. It is not clear whether it would extend only, for example, to a fund that invests as an ESG investor or relies on ESG investment strategies. Another issue is whether it would apply if any underlying investments, such as in a target date fund, mutual fund or collective investment trust, applies either

4401 N. Fairfax Drive | Suite 600 | Arlington, VA 22203
P 703.516.9300 | F 703.516.9308 | info@usaretirement.org | usaretirement.org

ESG principles in their investment "assessment, judgements or mandates." If the Proposal is intended to apply to any underlying investments, if so, these requirements may be impracticable. For proprietary, and other reasons, it may not be possible for a fiduciary to know all of the underlying investments in a particular fund product.

ESGs as Qualified Default Investment Alternatives—Proposed 29 CFR sec. 2550.404a-1(c)(3)(iii)

- **The ARA believes otherwise-qualifying investments that include ESG considerations should not be prohibited from qualifying as Qualified Default Investment Alternatives (QDIAs) or as a component a QDIA.**

The Proposal would also effectively prohibit ESG investments to be "added as, or a component of, a qualified default investment alternative." Notwithstanding that such an investment option may meet the Proposal's other heightened requirements for investments selected for individual account plans, DOL explains that "investment funds whose objectives include non-pecuniary goals—even if selected by fiduciaries only on the basis of objective risk-return criteria consistent with the Proposal's other requirements— should be the default investment option in an ERISA plan. ERISA is a statute whose overriding concern relevant here has always been providing a secure retirement for American workers and retirees, and it is inappropriate for participants to be defaulted into a retirement savings fund with other objectives absent their affirmative decision."

The ARA strongly disagrees with the Proposal's prohibition on including ESG investments as QDIAs. Under the Proposal, even if a fiduciary can prove that ESG investments are superior on the basis of objective risk-return criteria consistent with the Proposal's other requirements, they may not be included as, or as part of, a QDIA. This rule plainly excludes otherwise-qualifying investment options solely because their objectives include ESG factors.

Assuming that evaluating and validating the governance process of a potential corporate investment is part of a prudent investment process (as discussed above, under "Discussion"), the Proposal would seem to mean that if a target date fund (TDF) incorporates such prudent processes in its investment management, it would be precluded from being a QDIA. In other words, a TDF could be excluded from being a QDIA merely by following a prudent process incorporating an evaluation of corporate governance. Such a result would be entirely incongruous with the underlying objective of the proposal, which is to promote prudent investing of plan in the best of interests of participants.

Further, the ARA believes that if a fund performs well under a fiduciary's analysis and participants can redirect the investment of their account, as required by the QDIA rules, the presence of ESG factors should not preclude the investment from being used as the default. According to a 2018 survey conducted by the Plan Sponsor Council of America, 69.7% of employer-sponsored defined

AMERICAN RETIREMENT ASSOCIATION
4401 N. Fairfax Drive | Suite 600 | Arlington, VA 22203
P 703.516.9300 | F 703.516.9308 | info@usaretirement.org | usaretirement.org

contribution plans have QDIAs.[12] In plans with more than 5,000 participants, the percentage was 85.6%. The ARA believes that a prohibition on including ESG investments as or as part of, QDIAs would have a significant deleterious effect on retirement plan participation simply because fewer QDIAs would be available in the market than might otherwise be the case.

Finally, part of DOL's rationale for excluding ESG funds from QDIAs – that "it is inappropriate for participants to be defaulted into a retirement savings fund with other objectives absent their affirmative decision" – is unexpected. After all, QDIAs are explicitly permitted to include employer securities in two circumstances, including when they are acquired as a matching contribution. This contrasts with the DOL's assertion that ESG funds should be excluded from QDIAs because it is inappropriate to default participants into a retirement savings fund with other objectives absent their affirmative decision. In promulgating the QDIA regulation in 2007, the DOL expressed the view that "an absolute prohibition against holding or investing in employer securities may be unnecessarily limiting and complicated."[13] We believe that an absolute prohibition on ESG considerations in a QDIA is also unnecessarily limiting, might well be complicated, and ultimately deny participants the full benefit of a prudent investment selection.

Conclusion

The ARA very much appreciates the DOL's commitment to safeguarding America's workers' interests in their workplace retirement savings plans. The ARA shares this goal and would welcome the opportunity to discuss this further with you. Please feel free to contact Allison Wielobob, General Counsel, at AWielobob@USARetirement.org. Thank you for your time and consideration.

Sincerely,

/s/ Brian H. Graff, Esq., APM
Executive Director/CEO
American Retirement Association

/s/ Will Hansen, Esq.
Chief Government Affairs Officer
American Retirement Association

/s/ Allison Wielobob
General Counsel
American Retirement Association

[12] Plan Sponsor Council of America's *62nd Annual Survey of Profit Sharing and 401(k) Plans,* at Table 82, *available at* https://www.psca.org/research/401k/62ndAR.
[13] 72 Fed. Reg, 60452, 60458 (Oct. 24, 2007).